Canada. Royal commission on taxation.

Hearings. v. 96-98, 1964

1966

1946

ROYAL COMMISSION

ON

TAXATION

HEARINGS

HELD AT

OTTAWA

ONT.

VOLUME No.: 96

DATE: JAN 22 1964

OFFICIAL REPORTERS
ANGUS, STONEHOUSE & CO. LTD.
BOARD OF TRADE BLDG.
11 ADELAIDE ST. W.
TORONTO

364-5865 364-7383

ROYAL COMMISSION ON TAXATION

Proceedings of hearings held before the Royal Commission on Taxation, in the Supreme Court of Canada Building, Ottawa, Ontario, commencing at 9.30 a.m., on Wednesday, January 22, 1964

COMMISSION:

Mr. Kenneth LeM. Carter -- Chairman

Mr. Harvey Perry

Mr. Donald M. Grant

Mrs. S.M. Milne

Mr. Charles E.S. Walls

LEGAL ADVISER:

Mr. J.L. Stewart, Q.C.

RESEARCH DIRECTOR:

Prof. .D.G. Hartle

SECRETARY:

Mr. G.L. Bennett

---0---

INDEX TO EXHIBITS

NO.	DESCRIPTION	PAGE
334	Submission of Canadian Petroleum Association.	8901
335	Appendix to the Submission of Canadian Petroleum Association.	8901
336	Study submitted by Canadian Petroleum Association, being a Comparison of Canadian and United States Companies Operating in the Oil Industry in Canada.	8901
337	Condensation prepared by Mr. Stewart.	8917
338	Two pages from "Accounting Problems in the Oil and Gas Industry".	8925
339	Document showing various calculations and signed "D. J. Morrison, January 15, 1964".	8996

* * * * *

SUBMISSION OF

CANADIAN PETROLEUM ASSOCIATION

APPEARANCES

Mr. Charles Hay, Chairman,
Board of Governors,
Canadian Petroleum Association.

Mr. J. M. Smith,
Woods Gordon & Co.

Mr. W. C. Howells
Member of the Board of Governors of
Canadian Petroleum Association.

Mr. W. D. Stuart,
Manager, Ottawa office, Canadian
Petroleum Association.

Mr. D. A. McGregor,
Clarkson Gordon & Co.

Mr. D. J. Morrison,
Member of Tax Committee of the
Canadian Petroleum Association.

Mr. W. P. Taylor
Chairman of Tax Committee of the
Canadian Petroleum Association.

THE CHAIRMAN: Mr. Secretary?

THE SECRETARY: Good morning, Mr. Chairman and Commissioners.

Today we have a submission from the Canadian Petroleum Association. Mr. C. Hay who is the President of the Royalite Company, Calgary and Chairman of the Board of Governors of the Association is here this morning with his associates.

Mr. Hay would like to make an opening

statement and introduce his colleagues to you.

I would like to enter this submission into the record as Exhibit 334. At the same time, I would like to enter an Appendix to the submission as Exhibit 335, and a further study submitted by the Association, being a Comparison of Canadian and United States Companies Operating in the Oil Industry in Canada, which will be Exhibit 336.

---EXHIBIT NO. 334: Submission of Canadian Petroleum Association.

---EXHIBIT NO. 335: Appendix to the Submission of Canadian Petroleum Association.

---EXHIBIT NO. 336: Study submitted by Canadian Petroleum Association, being a Comparison of Canadian and United States Companies Operating in the Oil Industry in Canada.

THE CHAIRMAN: Thank you.

Good morning Mr. Hay, we are very glad to see you indeed and to receive what you have put before us. I must acknowledge the amount of work you have done for us; it is quite a task. I am delighted to see that you have waded through a comparison of the United States and Canadian taxes as they apply in certain conditions. That is very important to our work.

We have heard a little about the oil

industry from three or four witnesses who have appeared before us. This is the last appearance we will have with regard to oil, and I must say it seems to me that you have rounded up the whole very well in your submission. I think we will be gradually learning a little about the difficulties of your industry, which is a little different from everything else. Of course, everything is different from everything else, but this is perhaps a little more so. We are certainly trying our best to understand the involved portions of it, and I think at the end of the day we will have accomplished a little more. Thank you very much indeed, Mr. Hay.

We will be very grateful if you will now introduce your associates.

MR. HAY: Thank you, Mr. Chairman.

My associates appearing with me this morning are: on my immediate right, Mr. J. M. Smith of Woods Gordon & Co.; Mr. W. C. Howells, a Member of the Board of Governors of the Canadian Petroleum Association; and Mr. W. D. Stuart, Manager of the Ottawa office of the Canadian Petroleum Association.

On my immediate left are: Mr. D. A. McGregor of Clarkson Gordon & Co.; Mr. D. J. Morrison, a Member of the Tax Committee of the Canadian Petroleum Association; and Mr. W. P. Taylor, Chairman of the Tax Committee of the Canadian Petroleum Association.

THE CHAIRMAN: Thank you. Do you wish

to make some opening remarks?

MR. HAY: Yes, I would like to do so.

In our brief, we have endeavoured to portray the significance of our industry to the nation, as a principal source of energy and as it affects employment and the balance of payments. Crude oil and natural gas from Western Canada reaches the Pacific and Eastern Canada. It reaches the United States through pipe lines serving an area of that country which appears to offer substantial market growth, particularly in the 1970's. We have shown the money that has been spent, the earnings that have been made and the investment which is essential for future development.

Some details are shown of the efforts made by the Provincial Governments to keep pace with the changing fortunes of the industry. Land policies have been changed from time to time. Conservation and proration regulations have been revised to improve the efficiency of developing discoveries and recovering maximum quantities from reservoirs. Research is under way in many producing areas throughout the world. Much of it is available to the Canadian industry and is applied to our problem through research laboratories here in Canada. Tax revisions are also necessary if the industry is to continue to maintain its role in the growth and development of our country.

The length of the time periods involved in various phases of exploration and production is

not generally appreciated. Reports, many from outside the industry, correctly state that we have the ability to produce 70 per cent more crude oil and condensate than we are selling today, that we have a surplus of gas, enough proven reserves of crude oil to last 19 or 20 years at today's rate of production, and that production from the tar sands is, relatively speaking, just around the corner.

On the other hand, placed in their proper perspective as to time, the estimated demand for crude oil, coupled with the present rate of discoveries, shows that by 1970 the ability of the industry to produce market requirements will be used near to capacity and proven reserves will be no more than adequate for 12 or 13 years, a ratio regarded as minimal. Before 1970, we will need to spend nearly four and one-half billion dollars to discover and develop the crude oil and natural gas needed to meet markets. It is a considered opinion that there remains three to four years of research and definitive engineering before construction could be started on a commercial development in the Athabasca tar sands and that a further three years would be needed to construct the plant. Further, in relation to the time requirements, at least five or six years are needed to bring a contemplated exploration program to fruition or abandonment.

Let me take a moment to outline the time involved in bringing one project into pro-

duction. The Snipe Lake field in Northern Alberta was discovered late in 1962. The company I work for acquired a reservation in this area on January 14, 1952. An agreement was made with another company holding an adjacent reservation, for joint exploration of the combined area. After completion of seismic work, a well was started late in 1955. This well was abandoned in January, 1956, as a dry hole. When the time limit on the reservations expired, the partners acquired leases for the maximum area allowable. After further study, it was decided to drill at least one more well. Before starting the well, drilling reservations were requested to obtain the rights to areas which had reverted to the province but which would be evaluated by additional drilling. However, these reservations were acquired by another company and two more wells were drilled in 1961. Both of these were dry but it is interesting to note that subsequent development has shown that the first of these last two wells missed production by only half a mile. The original partners completed five producing wells in 1963, over ten years after the start of the project. Additional wells will be completed this year.

Against this background it is evident that the industry must begin now to increase its exploration activity.

We have spent considerable time and effort in attempting to evaluate the impact of our proposals. The principal advantage of a 25 per cent

gross depletion allowance deducted before drilling and exploration costs, is a deferment of tax payments during a period of expansion. The brief shows that expansion of the industry must continue, to meet the expected demand in 1970.

The Association believes that the allowance of drilling and exploration costs as a deduction from all income of individuals or corporations will attract additional investment in the industry from Canadian sources.

Alternatives to these recommendations have been considered. Crude oil prices might be raised by the implementation of a tariff or import quota. However, higher prices could lead to a loss of export markets and increased cost of energy to other Canadian industries.

An additional allowance on exploration costs has also been considered. In the opinion of the Association such an allowance would be difficult to administer and would not result in the most efficient use of available funds.

It must also be noted that alternative recommendations may increase the rate of return earned by the industry without removing the present advantage of United States investors to invest in the Canadian industry which accrues under the United States tax provisions. In view of the urgent need for additional capital, this source of funds must not be discouraged. Instead a positive approach must be taken giving Canadians equal opportunity to participate in the industry.

It is forecast that the need for oil and gas which can be supplied from Canadian resources will continue to increase over the next decade at the same rate as it has in the past. If Canada is to take advantage of this opportunity for growth it will require the best efforts of industry and all levels of government. The Association hopes its submission will be a factor in meeting this challenge.

THE CHAIRMAN: Thank you. Your submission certainly tells a story of remarkable achievement since 1947, and I shudder to think what the Canadian exchange position would be if we were not close to self-sufficient in regard to our own fuel. You make that point very clearly.

To do justice to what you have put before us, we have asked our counsel, Mr. Stewart, to lead the questioning, and we, of course, may join him from time to time; it does not exclude us. There is a good deal here which is of a technical nature and which is detailed, and it seemed to us that we would examine it in a more thorough manner with the help of Mr. Stewart.

Mr. Stewart, will you proceed?

MR. STEWART: Thank you, Mr. Chairman.

Gentlemen, one of the representatives of your industry which has appeared before this Commission in the past is the Independent Petroleum Association. We discussed with them the significance

of the word "independent".

My recollection is that the substance of what they said on that point was that an independent company in Canada is regarded as one whose income is essentially from Canadian sources, and that the word "independent" is used in contrast with the word "international" which relates basically to the major international companies. Would that be substantially your view as to the distinction between an independent and a non-independent?

MR. HAY: Yes, I think we would agree with the IPAC definition. The word "independent" is adopted by custom. IPAC adopts the name and is recognized by custom and usage. There does not appear to be available a very precise definition. Perhaps it has grown from usage. I suppose when the industry started it was not too much trouble to distinguish between a major and an independent. The industry simply said that anyone in a standard group was a major and anyone else was an independent. As the industry developed, independents grew and got bigger, and their size in relation to other companies placed them in somewhat similar circumstances to the majors, and they came to be known as majors. They got to be quite large. Then independents started to grow again and they again stayed independent until such time as the industry started to refer to them as majors.

The process of integration during that

course of growth, of course, moved them closer to being classed as majors.

MR. SMITH: Mr. Stewart, you said one of the criteria would be income from Canadian sources?

MR. STEWART: I think this was what we were told.

MR. SMITH: One could imagine a Canadian independent deriving its income from exports, for example. I would not have thought income from Canadian sources would be the test, surely.

MR. STEWART: I see. Well, I think I should perhaps qualify that and say income from Canadian production.

MR. SMITH: Yes. Then I understand, yes.

MR. HAY: As the industry moved into Canada and the people who were independents in the States established themselves in Canada, they brought with them the connotation of major and independent. Then as more Canadian companies were formed and started to operate and depended solely on their income from Canadian operations, they came to be Canadian independents, and those who came into Canada with associations from the States were regarded by the industry -- although their operations might be relatively small in Canada -- still not as Canadian independents.

The Canadian Independent Petroleum

Association started at a time when there was special interest in selling Canadian crude, and it concentrated upon attracting members whose sale of crude from Canadian production would not be in conflict with any interest they might have in selling crude produced elsewhere.

MR. STEWART: Yes.

MR. HAY: So, at the start of the Independent Petroleum Association, the principal criterion for membership was that prospective members should have an interest primarily and almost solely in producing crude from Canadian sources; that type of interest was felt to be most desirable for membership.

MR. STEWART: I take it that your Association includes people who would be classified as independents on this test and people who would not be so classified.

MR. HAY: That is right. The criterion for membership in the Canadian Petroleum Association is that prospective members be interested in land and land operations -- that is, as related to the petroleum industry -- and exploration and production. We also have a category for associate members which includes all those who are interested in the progress of the industry. This latter category, of course, has no voice in the operation of the Association.

MR. STEWART: Thank you very much, Mr. Hay.

My questions this morning are going to relate essentially to the tax structure side of this matter and to the position under Section 83 (a), and the position with regard to depletion. I have found this submission of yours (which the Secretary has identified as Exhibit 336, the Comparative Study) to be extremely interesting. I propose to base my questioning to some extent on what appears in that particular submission.

I observe, first of all, looking at your main submission, on page III-18 starting at paragraph 45, you indicate that this study was designed to show the net tax cost in certain types of companies which you mention. Then in paragraph 46 you say that this study assumes the

--

--

--

--

companies had no previous exploration of production operations in Canada and that each of them undertakes the same hypothetical annual ten well drilling program over a 25-year program. Then, for the purposes of your study, you take a success ratio and costs and revenues which reflect the 1962 experience of the industry. Then you indicate that you base your tax calculations on current tax legislation.

I take it from what you have said as well in the brief, that 1962 costs and finding rates were not particularly favourable judged historically.

MR. HAY: That is true, yes.

MR. STEWART: But I take it that you nevertheless consider that this submission (Exhibit 336) is a fair indication for the Commission's purposes of what might happen in a case of this kind.

MR. HAY: I think these are the best assumptions we can make at this time.

MR. STEWART: I would like to show you, Mr. Hay, a condensation which I have had put together of some of the figures which appear in the schedules to your study. I would like to explain to you how I arrived at my particular figures because I am then going to ask you to discuss some of these figures with me.

I have, as you will observe, three columns. Of these three columns one relates to a

Canadian non-integrated company, one to a Canadian integrated company, and the other to a United States corporation. The figures which appear under the first column are taken from the third page of Schedule V to your study, that is the last column of Schedule V. You will observe I have taken from that page simply the figure for net production income; that is the total amount of net production income, the total amount during a 25-year period of drilling and exploration costs, administration costs and capital costs allowance. Then I have telescoped this to some extent and shown the depletion figure which appears in the right hand column. I have then totalled the four items of drilling and exploration, administration, capital cost and depletion, and I then secure the figure of taxable income which appears on Schedule V.

Is what I have done so far clear?

MR. HAY: Yes.

MR. STEWART: Then in the column headed "Canadian Integrated" I have worked from your Schedule VI, which is a schedule related to Canadian integrated companies. While the first figures on the page do not appear in Schedule VI, I have assumed that the figures for net production income, drilling and exploration, administration and capital cost allowances would be the same for the integrated companies as they would for the non-integrated companies. Would that be so?

MR. HAY: Yes.

MR. STEWART: So again, I have totalled the four items which I have shown as deductions, and when I subtract the total from the figure of net production income I have a figure of taxable income which is not quite the same as your figure, but I think one of us has made a small error in the mathematics somewhere. Then on the right hand side I have taken figures from Schedule VII, and more particularly the right hand column on the third page of that schedule, and there again you will observe that I have taken in this case exactly what you have on the top half of the third page.

I have prepared this condensation essentially for ease of reference. May I take it we can proceed on the basis that this is a fair condensation of the material you have referred to.

MR. McGREGOR: I agree with that.

MR. STEWART: I would like to take these things one by one and start with net production income which of course is common to all three companies and I think that your figure is based on the material which appears on page 6 of your study. About halfway down page 6 you show a figure of net monthly income per well of $2,883, which you round off at $2,880. I take it that if we take the $2,880 and multiply it by the number of months of production during the 25-year period, and assuming as you do on page 6, that each year six of the ten wells drilled are successful, we end up with a total of $64,368,000, is that correct?

MR. McGREGOR: That is correct.

MR. STEWART: The first year of a particular well's production, as you show on top of page 7, the well produces $86,400 worth of product and this, as you show in the next sentence on page 7 in each succeeding year during the period each well is considered to produce products having a value of $207,360. If I multiply $86,400 by 25, if there are 25 years involved here and if I multiply $207,360 by 300, which is the total of all the digits 1 to 24, I end up with $64,368,000.

MR. McGREGOR: I think you will find

the annual increment of income goes up each year by $208,000.

MR. STEWART: I take it that in Western Canada, it is reasonable to think of oil wells having the 25-year life that you are assuming for the purposes of this study.

MR. McGREGOR: Yes, I think that is right.

MR. STEWART: Well now, then we come to the deductions and I would like to take them one at a time and make sure that we understand one another. The first one is drilling and exploration and there I turn first of all to Schedule IV of your study. I think that in this connection I will try to deal in the first instance with the Canadian experience. You show on Schedule IV that there are three items included in exploration and drilling expenses. There is first of all exploration and development drilling and secondly geological and geophysical expenditures and thirdly land acquisition and rentals. If we turn to page 7 of the study you show under the heading "Exploration and Development Drilling" how you arrive at the figure of $770,000 which appears on Schedule IV. Is that correct?

MR. McGREGOR: Yes, sir.

MR. STEWART: On page 7 under the heading, "Geological and Geophysical Expenditures", you arrive at a figure of $205,000, which is the amount again which appears on Schedule IV.

MR. McGREGOR: Yes.

MR. STEWART: And by the same token on page 7 under the heading, "Land Acquisitions and Rentals" you indicate how you arrive at the figure of $475,000 per year which you use on Schedule IV and Schedule V. Is that correct?

MR. McGREGOR: Yes.

MR. STEWART: Now, I think perhaps if I stick to the Canadian situation at the moment and move to this item of administration which appears on my condensation -- I think perhaps, Mr. Chairman, if I may interject at this stage for the purposes of the record it may be well if we had this condensation market as an exhibit.

THE CHAIRMAN: Very good.

THE SECRETARY: Exhibit 337.

EXHIBIT 337: Condensation prepared by Mr. Stewart.

MR. STEWART: This item of administration, I think, is picked up from page 6 of your study and I observe that at the top of the page where you have been dealing with 1962 experience of the industry you show that administrative expenses amounted to 5.8% of net production income and I take it that the figure which we have on my condensation of $3,773,000 odd is 5.8% of $64 million.

MR. McGREGOR: That is correct.

MR. STEWART: May I ask you this: Is this administrative expense, which is not attributable to drilling and exploration for the purposes

of Section 83(a)? If I may enlarge on that, it is my understanding that for Section 83(a) purposes you are entitled to allocate your administrative expenses and treat the appropriate portion as related to exploration and drilling.

MR. McGREGOR: That is correct.

MR. STEWART: This item of $3,700,000 would be a portion of the administrative expenses of the company concerned which could not be so allocated.

MR. McGREGOR: I think it could be, Mr. Stewart. It could really be considered as an exploration cost.

MR. STEWART: You do.

MR. McGREGOR: Yes.

MR. STEWART: This would be equally so for the integrated Canadian company.

MR. McGREGOR: I think we can assume that in the case of an integrated company a portion of their administrative might have been allocated to their other functions. I think we can assume this is a reasonable allocation in the case of a producing operation.

MR. STEWART: I was a little curious then to know why you showed the two items. If drilling and exploration expense is intended to be a Section 83(a) item, it could really be increased then by the addition of the administrative expense.

MR. McGREGOR: Yes.

MR. STEWART: Well then, we come to the

Canadian figure for which I have used the expression capital cost allowance and there I go back to page 7 of your study and I observe that at the bottom of that page you deal with production equipment and at the top of page 8 you indicate that the annual expenditure on production equipment is $150,000 and I notice on Schedule V that the rate which is allowed for capital cost allowance purposes on production equipment is 30%.

MR. McGREGOR: Yes.

MR. STEWART: And then you also on page 8 analyse the situation with regard to gas plant and other equipment and at the bottom of the page you indicate that the annual expenditure on that type of equipment is $108,400 and from Schedule V I observe that the capital cost allowance on that type of equipment is at the rate of 20%.

MR. McGREGOR: Yes.

MR. STEWART: So that if we take these annual amounts and annual rates for the 25-year period we end up with this figure for the Canadian non-integrated and Canadian integrated companies of $5,678,000.

MR. McGREGOR: That is correct.

MR. STEWART: I would then like to go back to this Canadian item of drilling and exploration which perhaps can be combined with the administrative figure and the operation of this allowance is reflected in Schedule V and, just in passing, if we look at the first page of Schedule V we see that

there is a line headed, "Cumulative Section 83(a) carried forward" and that carried forward continually increases during the first nine years and then on page 2, on the tenth year it begins to decrease and by the eighteenth year that carry-forward has been absorbed and of course on page 3 there is no carry-forward of Section 83(a) expense.

I would like to ask some questions about this carry-forward in the face of this. All these exploration and drilling and administrative expenses are deductible for tax purposes.

MR. McGREGOR: Right.

MR. STEWART: Now, we have seen from Schedule IV that the items in question include land acquisition costs. I take it that in this regard there is a distinction between land acquisitions prior to and since April 10th, 1962.

MR. McGREGOR: For the purposes of this study, Mr. Stewart, we assume that all the land acquisitions were deductible.

MR. STEWART: Quite so, because this is a new enterprise.

MR. McGREGOR: Correct.

MR. STEWART: In your submission on page 3.7 you deal with the question of land acquisitions costs where the lands were acquired prior to April 10, 1962. You estimate that the net cash expenditures from 1948 through 1962, published by your Association indicate that the total expenditures on land acquisitions and rentals were

$1.36 billion.

Now, I am afraid I am not as familiar as I should be with your publications but where would we find these figures published?

MR. McGREGOR: These figures are in the Canadian Petroleum Association Statistical Year Book.

MR. STEWART: Then you go on to break down this figure of $1.36 billion to some extent. You estimate that the amount expended on land acquisitions would be $900 million. Now, you say that is based on provincial rental statistics. Do I take it that you have obtained reasonably accurate figures as to the provincial income from rentals and that you have concluded that they represent about one-third of the total?

MR. McGREGOR: That is correct.

MR. SMITH: Mr. Stewart, I think it should be pointed out that we show in our Section 2 on page 18 a figure for land rentals payments provided from provincial government reports.

MR. STEWART: That is the figure of $414 million.

MR. SMITH: Yes, I think there would be a tie-in there.

MR. STEWART: Well then, you also show on page 3.7 that most of this $900 million or by far the major part of it will never qualify as a deduction for tax purposes. These are expenditures, I take it, that are recoverable, if at all,

through operation of the depletion allowance.

MR. McGREGOR: Yes. That would be the only avenue we have.

MR. STEWART: I don't suppose you have any idea as to what proportion of the $900 million is likely to be recoverable through depletion?

MR. McGREGOR: Mr. Stewart, at the end of 1962 I believe we estimated, based on a study, that the industry as a whole has enjoyed a depletion expense of $150 million since 1947.

MR. STEWART: I appreciate that. I am thinking now of the fact that some part of this $900 million presumably relates to expenditures by companies which never had an income of any kind or if they had an income it never will be recovered for tax purposes.

MR. McGREGOR: That is right.

MR. STEWART: Any idea what proportion that would be?

MR. McGREGOR: No, I couldn't say, Mr. Stewart.

MR. STEWART: Dealing with Section 83(a), the deduction, am I correct in thinking that this deduction can and must be taken as income becomes available?

MR. McGREGOR: That is correct.

MR. STEWART: It can then be taken from income from all sources in the cases I am talking about of the company whose principal business is in the petroleum field.

MR. McGREGOR: That is correct.

MR. STEWART: If we can imagine this type of situation; a company which incurs exploration and drilling expense and which has no production income, but has other income, would in effect get the deduction under Section 83(a) at the 52% rate.

MR. McGREGOR: No, the 50% rate.

MR. STEWART: This deduction under Section 83(a) can be carried forward indefinitely.

MR. McGREGOR: Right.

MR. STEWART: So that there is no tax on production actually until these Section 83(a) costs are absorbed?

MR. McGREGOR: That is correct.

MR. STEWART: When they are absorbed and we get into the question of taxation, the depletion allowance also comes into operation.

MR. McGREGOR: That is right.

MR. STEWART: If we look at your main submission on Table 15 which appears opposite page 3.19 we find that in the case of the Canadian non-integrated company, with which our study deals, no taxes are paid for the first 17 years of this venture.

MR. McGREGOR: Yes, that is true.

MR. STEWART: In the case of the Canadian integrated company, dealt with in your study, no taxes are paid for the first nine years of this venture.

MR. McGREGOR: Yes, that is correct.

THE CHAIRMAN: Mr. Stewart, one point

before we move on. I see that Section 83(a) expenses include capital cost allowance in the illustration.

MR. STEWART: Well, no. I think not, Mr. Chairman. I am going to go into capital cost at a later stage.

THE CHAIRMAN: All right.

MR. STEWART: Perhaps we can confirm this from these gentlemen but it is my understanding that capital cost of depreciable assets is recovered under normal operation of capital cost allowance but not through Section 83(a).

MR. McGREGOR: That is true.

THE CHAIRMAN: So you do carry forward on Schedule V along with drilling and exploration and administration?

MR. STEWART: It is a fair allowance, Mr. Chairman, because if it were not obviously you would be getting all the capital costs at 100% or might be taken --

MR. McGREGOR: Actually, I think, Mr. Stewart, the net amount carried forward of 83(a) expenditures is somewhat less than our drilling and exploration expenses because our income for the first year exceeds our administrative expenses and capital cost allowance.

MR. STEWART: This may be an unusual example in that case but that is the way it works out.

MR. McGREGOR: Yes.

MR. STEWART: Having regard to the

position under Section 83(a) I am going to ask you to comment on the normal accounting treatment of items of this sort for corporate purposes and in that connection I have indicated to your Mr. Stuart that I propose today to refer to pages 50 and 51 of a study entitled, "Accounting Problems in the Oil and Gas Industry" which was recently published by the Canadian Institute of Chartered Accountants. I have got some copies of page 50 and 51 which I would be glad to give to you.

Mr. Chairman, I think we might also perhaps have these pages marked as an exhibit.

EXHIBIT 338: Two pages from "Accounting Problems in the Oil and Gas Industry".

MR. STEWART: Now, the paragraphs on these pages in which I am particularly interested are paragraphs Nos. 3 to 7. Probably I could ask you to take them one at a time.

Paragraph 3 suggests or appears to suggest that for purposes of corporate accounting the cost referred to in the paragraph should be capitalized as part of the costs of the reserves ultimately developed. What would your comment be on that?

MR. McGREGOR: Well, there are enough concepts of accounting. I think latterly there has been a trend towards thinking more of capitalizing some of these costs than there has been in the past but I think as yet most companies do write off their

rentals and their geological and geophysical expenditures on a year to year basis rather than capitalize.

MR. STEWART: In any event I take it that the taxation treatment of costs of this sort in Canada is extremely favourable?

MR. McGREGOR: I would say so, yes.

MR. STEWART: Well then, as far as paragraph 4 is concerned the suggestion appears to be that these costs should be treated on an area of interest basis. What would you have to say about that?

MR. McGREGOR: Some of us who were involved in this study, Mr. Stewart, had some question about an area of interest concept. It is one of the matters the Committee will look into in the future. One difficulty with the area of interest is that, as I see it, if we take the example Mr. Hay gave of say Snipe Lake, where the industry carries on a development program for 10 years, you can imagine the cumulative costs you would have for rentals, seismeographs, dry holes and so on. If we go down to a ten-year period and no production was found, then we would have a tremendous charge against our profit and loss account in that year as distinct from charges over the period for rentals, dry holes and so on; so some of us feel that the area of interest concept may result in very drastic charges to profit and loss and the suggestion has been that even with the area of interest concept you would still

have to have a yearly amortization charge or some type in order to spread this out.

MR. STEWART: Well, perhaps I am anticipating myself at the moment but do similar problems arise if depletion is allowed on a property by property basis?

MR. McGREGOR: I don't quite get your point, Mr. Stewart.

MR. STEWART: Well, as I understand the American system of depletion, the amount is determined on a property by property basis.

MR. McGREGOR: Yes, that is true.

MR. STEWART: If your Snipe Lake situation had occurred in the United States or under the American rules, would you not have had this accumulation of costs until it was determined whether or not there was production?

MR. McGREGOR: Not necessarily. If the American company spent intangibles, which most of them do, these would be charges against income in the year they are made. For instance, if there were dry holes. In other words, the majority of costs would not be ---

MR. MORRISON: There is another thing I might mention in that the summary attached set out at one stage this is a conversion from reservation to lease. Under the area of interest concept, as I understand it, there has been a study, the full amount of the expenditures would be

deferred entirely as part of the cost of the area of interest even though 50% of the area reverted to the Crown. My understanding of the American situation is that 50% of the expenses incurred before that reversal could also be written off at that time.

MR. STEWART: Well then, what about paragraph 5? Have you any comment on that?

MR. McGREGOR: There are some companies which capitalize their lease rentals at the present time. I think the majority of the industry write them off on a year to year basis as a normal operating charge.

MR. STEWART: So this, I take it -- what is suggested here as desirable accounting practice -- is not in accordance with current industry practice?

MR. McGREGOR: It is not in general, no.

MR. STEWART: What about paragraph 6? I suppose the comments you have already made will necessarily affect your attitude towards paragraph 6.

MR. McGREGOR: Yes, to the extent the company has been writing off their geological-geophysical land rentals, dry holes, and so on. The remaining cost to be capitalized will obviously be less than this study would suggest and therefore their depletion charge would be less by virtue of lesser costs.

MR. HAY: Mr. Stewart, at the risk of speaking of an area about which I know little, my concern about this concept is the use of the word "occasionally", "occasionally no reserves will be found". I think occasionally reserves will be found. By far the largest part of our transactions as far as bookkeeping is concerned and as far as our work is concerned, is in regard to failures in finding oil. Snipe Lake is the exception not the rule.

MR. STEWART: I would have accepted that proposition, Mr. Hay, more readily if I had not looked at your study. Apparently 1962 was a year of comparatively poor finding rates, but a substantial

portion of both the exploration and development wells that were drilled were successful.

MR. HAY: This is exploration and development. The exploration is in a different category from development and I think we illustrate that in our brief elsewhere.

THE CHAIRMAN: Mr. Stewart, do I understand the answers which you have got indicate that we would have virtually the same balance sheet from an oil company for development and exploration whether or not it had been successful in its drilling?

MR. STEWART: I would prefer to toss that question, Mr. Chairman, to these gentlemen.

THE CHAIRMAN: Let us ask a witness if that is true.

MR. McGREGOR: Mr. Chairman, are you referring to this study? Are you referring to the concept under this study?

THE CHAIRMAN: I am indeed. I am referring to your answers to the questions Mr. Stewart has put to you and the accounting practices rather than what is laid down in the study. In most cases you said what was done did not follow what I have before me and what is before you, so I said I would assume the balance sheet would look pretty much the same irrespective of the success.

MR. McGREGOR: No. Under current practice, generally speaking the industry is capitalized in their land acquisition costs until they are proved

unproductive and they are capitalizing their successful drilling costs and writing off unsuccessful drilling costs. Under this concept it is suggested that you would accumulate costs which the industry is presently writing off and collect them in a pool until you have proved that an area is non-productive, and then they would be written off.

THE CHAIRMAN: You say current practice is to capitalize successful drilling?

MR. McGREGOR: Yes.

THE CHAIRMAN: But in the Snipe Lake illustration that would mean that everything up to the point where you drilled a well which turned out to be successful would have been written off. I think that is what you said. Therefore, the only amount that would have been capitalized are those costs relating to that particular well, not all that has gone before to develop the area.

MR. McGREGOR: That is correct.

THE CHAIRMAN: So there is that difference. Thank you. That is what I wanted to bring out. There are certain costs as a result of success which would be capitalized and without success would not be capitalized.

MR. McGREGOR: That is correct.

MR. STEWART: Have you any comment on the appropriateness of paragraph 7?

MR. McGREGOR: This is another point, Mr. Stewart, on which there is some disagreement. Generally, I do not know that it has received too much

favourable comment as yet. I know of no oil companies as yet which have adopted this policy in Canada. However, it is very similar to the capital cost situation which we have where excess capital cost is written in .

MR. STEWART: I would like to ask you one or two questions arising out of the fact that this Section 83(a) expense is deductible from income of all sources. The second column of Schedule VI is from Schedule 5; it shows the income of a Section 83(a) carry-forward position of a non-integrated company. Then the next column sets out the depletion allowance which the integrated company is permitted to take or is able to take. In the third column we find in the first nine years the amounts which the company has had to carry forward can be offset by the integrated company against other income. Is that the substance of it?

MR. McGREGOR: Yes.

MR. STEWART: I think if we look again at your table 15 it is made clear that the non-integrated company during the 25-year period pays $6,235,000 in taxes whereas the integrated company pays $5,085,000 in taxes. I take it this difference is due to the fact that we have assumed that the integrated company could set the Section 83(a) expenses in the early years off against other income.

MR. McGREGOR: That is correct.

THE CHAIRMAN: Mr. Stewart, we deduct all

the 83(a) expenses, do we not? In the case of the integrated company we are able to deduct them earlier than in the non-integrated company?

MR. STEWART: That is right, Mr. Chairman. But I should not be answering your question; let me put it to the witnesses in this way. If we take a simple example of an integrated company which has marketing and refining integrated, these Section 83(a) expenses, I take it, can be set off against that income?

MR. McGREGOR: Yes.

MR. STEWART: The non-integrated company in the ordinary case has no such off-setting income.

THE CHAIRMAN: And it improves the depletion.

MR. STEWART: I was going to come to the depletion aspect and put it to the witnesses in this way. The fact that the non-integrated company does not have off-setting income means not only that its depletion is deferred, it seems to mean that part of its depletion is lost forever for tax purposes.

MR. McGREGOR: That is correct. In other words, the integrated company would get depletion from similar properties at an earlier date.

MR. STEWART: What would your reaction be to a provision that this Section 83(a) expense should be deductible only from production income?

C-6

MR. McGREGOR: I do not think that the industry as such would care for that suggestion, Mr. Stewart. I think that the industry feels that the fact they have refining and marketing integrated is a question of investment at the time.

MR. STEWART: When you say the industry feels this way, as I understand your table 15, the effect of the present rule on your hypothetical case is that the non-integrated company is going to pay $1.2 million more in taxes than an integrated company over a 25-year period.

MR. McGREGOR: That is true.

MR. STEWART: Are you suggesting that non-integrated companies are happy about this?

MR. McGREGOR: The non-integrated companies, of course, would like to see an alliance based on gross income.

MR. STEWART: And so would the integrated companies, I take it.

MR. McGREGOR: Yes.

MR. STEWART: What is puzzling me is why there should be this distinction for tax purposes between the non-integrated and the integrated companies. I am trying to determine what the rationale of the distinction is.

MR. McGREGOR: We would like to go even further than that and allow any company to get a deduction of drilling exploration expense -- any company or individual.

THE CHAIRMAN: Any person?

MR. McGREGOR: Yes.

MR. STEWART: Yes, but this is not the point. You are now talking about someone who has other income. I am talking of someone who does not have other income. I am wondering whether it is equitable to have this deduction extend to anything but production income.

MR. McGREGOR: We feel it would be more equitable to extend it to all income.

THE CHAIRMAN: Therefore you feel there is no better case for extending it to refining and distributing income than there is for extending it to boots and shoes or anything else? Is that true?

MR. McGREGOR: That is correct, Mr. Chairman.

MR. STEWART: I think somewhere in your submission you have suggested that if we had gross depletion this particular disadvantage of the non-integrated company would disappear. I wonder if I have understood that correctly because, granted if we had a system of gross depletion everyone would receive the depletion allowance in respect of production income but as long as Section 83(a) remains in effect, would this difference remain in force?

MR. McGREGOR: The effect of the gross depletion would really be to push our 83(a) expenses ahead so far as the non-integrated company.

MR. STEWART: Yes?

MR. McGREGOR: I may have missed your point, sir.

MR. STEWART: There may not be a point. I am trying to puzzle this out.

This Section 83(a) deduction as it is now constituted can be carried forward indefinitely and is available against all income, with the result that a person who has other income can use it more rapidly than a person who has not other income.

MR. McGREGOR: Yes.

MR. STEWART: If we changed the depletion system to one of gross depletion, both the integrated and non-integrated companies will not be taxable until a later stage.

MR. McGREGOR: That is correct.

MR. STEWART: But will the integrated company or any company -- well, at the present time the integrated company, which has other income, will it not be able to absorb its Section 83(a) expenditure more rapidly than the non-integrated company?

MR. McGREGOR: If it has other income, yes, it will -- under any circumstance.

MR.HAY: I think Section 83(a) and the 25% gross depletion have been presented by the industry to government as a joint effort. They complement each other; they are both needed. 83(a) was only partly going towards solving the problem for the non-integrated company. They go hand in hand.

MR. STEWART: But you are not suggesting

Mr. Hay, that if gross depletion is introduced Section 83(a) will go?

MR. HAY: No; the two are needed to reach the objective.

MR. MORRISON: 83(a) now requires you to take exploration and drilling costs up to the amount of income before depletion. We believe that depletion should be the first charge, and 83(a) should be the second charge.

MR.STEWART: Yes, if we had a system of gross depletion we would have to alter the rule in that regard.

THE CHAIRMAN: Or even if we did not, of course, the rule could be altered in that regard. I think that is what Mr. Morrison means. He objects to 83(a) being deducted before one has depletion under the present rules, right?

MR. MORRISON: Yes, that is the basic problem.

MR. STEWART: That is the question of the definition of production profits.

COMMISSIONER GRANT: Before leaving table 15 may I ask a question to straighten out my own thinking to some extent on this?

Do I understand that under table 15 at the end of the 25-year period, both in the case of the non-integrated company and in the case of the integrated company, the total cost of exploration, drilling and depletion is going to be paid, that it is going to be returned, to be recovered out of income?

MR. STEWART: Mr. Grant, if you look at this summary of the situation which has been marked as Exhibit 337 you will see that we are dealing here with the 25 years in a nutshell, and you will observe that from the net production income we have deducted all the drilling and exploration expense, the administration expense, the capital cost allowances aggregating five hundred and six, and we have deducted the $6.2 million of depletion and there is left a taxable income of $12.4 million, on which table 15 estimates the tax to be $6.235 million. Is that right, Mr. McGregor?

MR. McGREGOR: Yes.

MR. STEWART: So that $51 million of deductions has been absorbed or has been applied against net production income to produce taxable income of $12 million and a tax of $6 million.

COMMISSIONER GRANT: Now we come to integrated companies and you have a difference of depletion. There is a higher depletion in the integrated company and hence less taxable income and less tax.

MR. STEWART: Yes.

COMMISSIONER GRANT: I just cannot see why that should be so because the straight production company, provided it has income to meet it, is going to have its cost --

MR. STEWART: I would like to put it to the witnesses that the answer really is to be found conveniently on Schedule VI.

BC/ng

C-11

Schedule VI, Mr. Grant, relates to the integrated company but the second column on the page is a summary of the position of the non-integrated company. As we have already said, the figures in brackets for the first nine years of the second column represent Section 83(a) expense of the integrated company, which it has not been able to absorb. Obviously when you have that accumulated expense -- the total of those figures for the first nine years -- it is going to be some time, and in fact in their example it takes about the next nine years before the integrated company has income which can pick up that expense.

COMMISSIONER GRANT: Right.

MR. STEWART: In the first nine years in the case of the integrated company, it is assumed that these Section 83(a) items are absorbed against other income.

COMMISSIONER GRANT: Yes.

MR. STEWART: The result is that in the tenth year, having absorbed all the Section 83(a) expense, the integrated company gets itself into a taxable position and its Section 83(a) expense is less than its income from production. Therefore it has production profits and therefore it gets depletion.

Is that the substance of it?

MR. HAY: Yes, that is correct.

MR. STEWART: And you will observe on Schedule VI. ---

THE CHAIRMAN: Just before we pass to that, Mr. Stewart, the integrated company does not get depletion until the tenth year, but its other charges, its production charges, its exploration charges are so great that it cannot benefit by depletion. Is that it? Is it not charged and carried forward?

MR. STEWART: There is no carry-forward because it is assumed the Section 83(a) item is utilized each year by way of off-set of income from other sources, so there is nothing to carry forward.

COMMISSIONER GRANT: I am not talking about the integrated company; I am talking about the non-integrated company.

MR. STEWART: The non-integrated company has what might be regarded as a Section 83(a) loss, and it is allowed to carry that loss forward until it uses it and it does not get to use it until the tenth year.

MR. McGREGOR: Mr. Grant, does this assist you? The integrated company uses up its expenses each year against its other income and then it gets depletion in the year when its production income exceeds --

COMMISSIONER GRANT: I was wondering if there was an interest element that placed the non-integrated company at a disadvantage?

MR. STEWART: If we can move back to 337 and deal with the position of the American company,

we are assuming, Mr. Hay, that the net production income is exactly the same.

MR. HAY: Yes.

MR. STEWART: Then when we get to the drilling and exploration expense, if we look at Schedule IV we find the annual amount, which in the case of the Canadian company totalled $1.45 million and in the case of the American company totalled only $1.218 million. I would now like to take the four items shown with regard to the United States company. The first is the exploration and development drilling, $650,000. I take it from page 9 of your study that you break drilling costs down between the intangibles and casing, and I think you make it clear elsewhere that in the United States the amount expended on casing is not allowed as a current expense but is treated as an expenditure subject to depreciation. So that is the difference between the two countries on that particular item.

Then the next item on Schedule IV is geological and geophysical, and you indicate on page 9 that this is allowed to the extent expended on non-producing properties, but that it is not allowed in the United States to the extent expended on producing properties.

MR. HAY: Yes.

MR. STEWART: So, on your assumption, $51,000, which is deducted, is treated as capitalized and appears again at the bottom of page 9 and as

C-14

something which is recoverable through depletion. Is that right?

MR. STEWART: The next two items on schedule four are land rentals and bonus cost of abandoned properties and I observe on page 9 you assume that lease rentals are 30 per cent of the whole item of $475,000. These are allowed in the United States. As far as lease acquisition costs are concerned 80 per cent is charged to expense. I take it these are properties which turned out to be non-productive.

MR. HAY: Yes.

MR. STEWART: Twenty per cent which relates to productive properties is not allowed as a current deduction in the United States, but that also appears at the bottom of page 9 as something which will be recovered through depletion.

MR. HAY: Yes.

MR. STEWART: So that as far as this exploration and drilling expense is concerned, the American treatment is less favourable than the Canadian.

MR. McGREGOR: Generally I think that is correct.

MR. STEWART: And that appears first of all from the total figures in the case of the United States company the annual charge is $1,218,000 whereas in the case of the Canadian company it is $1,450,000, the difference representing two items; one for $118,000 which in the United States is depletable and the other being $114,000 which in the United States is added to the cost of depreciable property.

THE CHAIRMAN: The cost of what?

MR. STEWART: Depreciable assets. It

is also the case in the United States that if a company has a loss as a result of its current charges this loss is treated as a normal loss for the purposes of the loss carry forward provisions.

THE McGREGOR: That is correct.

MR. STEWART: Whereas in Canada Section 83A items can be carried forward indefinitely.

MR. McGREGOR: That is true.

MR. STEWART: If we look at Exhibit 337, we find that on this particular item of drilling and exploration and in your particular hypothetical case the Canadian deduction is $5,800,000 higher over the 25 year period than the American deduction.

MR. McGREGOR: Yes.

MR. STEWART: Now, the administrative element is the same in all cases. We then go to the question of capital cost allowances.

THE CHAIRMAN: Would you like to break at this point, Mr. Stewart?

MR. STEWART: Yes, fine, Mr. Chairman.

THE CHAIRMAN: Let us stand over for 10 minutes.

---Short Recess.

---Upon Resuming.

THE CHAIRMAN: All right, Mr. Stewart.

MR. STEWART: Thank you, Mr. Chairman. Now, gentlemen, we were just about to switch to the question of depreciable properties and I think we have

established that in the case of an American company the depreciation base is higher because casing is treated as depreciable property for their purposes.

MR. McGREGOR: Yes, that is true, Mr. Stewart.

MR. STEWART: And in fact if we look at Schedule 7, this fact is borne out by your calculation of depreciation on the lower half of each page, the annual additions in the American case are shown as $372,400 where as in the case of the Canadian companies the annual additions were $268,400.

MR. McGREGOR: Correct.

MR. STEWART: I observe on Schedule 7 also that in the United States depreciation is calculated on a straight line basis at 6-2/3 per cent, which is a lower rate than the Canadian capital cost allowance rate.

MR. McGREGOR: Yes, that is true.

MR. STEWART: The combined effect of the large deprecation base and the lower rate is, looking at Exhibit 337, that a depreciation reduction in the American case over the 25 year period is about $1 million larger than the Canadian.

MR. McGREGOR: That is correct, Mr. Stewart.

MR. STEWART: Now, while we were touching on these distinctions between the American rules and the Canadian rules, I think you brought out in your submission that in the United States if petroleum properties are sold by a company of this sort any

gain which is realized is taxed on a capital gains basis.

MR. McGREGOR: Correct.

MR. STEWART: I take it in the United States the company gets no deduction in respect of its acquisition costs of properties? Perhaps I should qualify that just a little bit. I am thinking now about, let us say, the cost of purchasing a property. This would be treated as a capital item in the United States.

Mr. McGREGOR: That is correct.

MR. STEWART: Whereas in Canada these acquisition costs are treated as deductible and the proceeds of sale are treated as ordinary income.

MR. McGREGOR: That is true.

MR. STEWART: Well now, in the United States then all expenditures which are incurred by companies of this sort are deductible with two exceptions; the first exception being certain land acquisition costs and the certain geological and geophysical expenses which are capitalized and recovered through depletion.

MR. McGREGOR: Correct.

MR. STEWART: The second exception relates to depreciation property, the cost of which is recovered through normal depreciation allowance.

MR. McGREGOR: Yes.

MR. STEWART: In Canada all expenditures are allowed as current deductions except expenditures on depreciable properties the cost of which

is recovered through the capital cost allowance system.

MR. McGREGOR: Yes, sir.

MR. STEWART: Now then, we come to the subject of depletion and again looking at Exhibit 337 and starting with the non-integrated company, we, I take it, are in this position from what you have just said that there are no capital costs or other costs remaining to be recovered by virtue of the depletion allowance.

MR. McGREGOR: In the non-integrated company?

MR. STEWART: Yes. Or for that matter in the integrated company too.

MR. McGREGOR: Yes, we have recovered all our costs.

MR. STEWART: In the case of the non-integrated company, looking at Table 15, there is no production income until year 18 and year 20, and therefore no depletion until the year 18.

MR. McGREGOR: That is correct.

MR. STEWART: In the case of the intgrated company, there is no production income and, therefore, no depletion until the year 10.

MR. McGREGOR: That is true.

MR. STEWART: Now, as far as depletion in the United States is concerned, if we look at page 10 of your submission, we find first of all that you have assumed at the top of the page that each of these wells represents costs recoverable through depletion aggregating $20,000 or $120,000 per annum.

MR. McGREGOR: That is true.

MR. STEWART: So that if we take that $120,000 per year for 25 years, the amount which has been capitalized must be recovered through depreciation would aggregate $3 million. Is that correct?

MR. McGREGOR: Yes.

MR. STEWART: Now then, I find also on page 10 that in the first year of the operation of the wells that are brought in in a particular year, the depletion amounts to $2,000. That is the third item on page 10.

MR. McGREGOR: Yes, that is on a cost depletion basis.

MR. STEWART: So that under the American system and in your hypothetical case the first year's depletion in respect of particular wells is taken on the cost depletion basis at $2,000.

MR. McGREGOR: That is true.

MR. STEWART: And that you indicate later in the page that the percentage depreciation on the American system per well works at $11,642.

MR. McGREGOR: Yes.

MR. STEWART: And if we multiply that figure by six, which is the number of wells that assume to be brought in in each year, we get a figure of $69,852.

MR. McGREGOR: Yes, that is correct.

MR. STEWART: These figures a little lower down on the page of $69,582, I think, is a

typographical error. It should be $69,852; so that if we take the cost depletion for one year for each of the 25 years involved, that is $2,000 multiplied by 25, which comes to $50,000 that we take then $69,852 for each succeeding year and multiply that by 300, we get $20,955,600.

The figure of $69,852 is the percentage depletion per year and this is the cumulative effect. My figure of $300 is obtained by adding the numbers one to 24. I get $300. I multiply that out and I get a total of $20,955,600 and the total of that plus $50,000 comes to $21,500,600, which figure appears on our Exhibit.

MR. McGREGOR: Yes, that is correct.

THE CHAIRMAN: Excuse me, Mr. Stewart. You start by taking $2000 and multiply it by 25 and get $50,000. This is the cost depletion but you say the cost per well was $20,000.

MR. STEWART: Yes.

THE CHAIRMAN: You gave the cost of the well as $50,000.

MR. STEWART: No. As I understand this process it is this: each year we drill 10 new wells and each year we are assuming that we have six successful wells. The first year all we get is the cost depletion but that cost depletion each year relates to the wells that were drilled that year. Now, after that in the second and subsequent years, of which there are 24, we get percentage depletion at the rate of $69,000 a year so obviously in the year 25 we get

a percentage depletion on 24 year's wells.

THE CHAIRMAN: Yes.

MR. STEWART: To let you add one to 24 and get 300 and multiply that through.

THE CHAIRMAN: The point is once you run out of cost depletion you turn over to percentage depletion.

MR. STEWART: No. You take the percentage depletion, as I understand the American system unless the cost depletion is more favourable to you in which event you must take the cost depletion.

MR. McGREGOR: That is right.

MR. STEWART: So this $250,000 is in respect of those years when cost depletion was more favourable.

MR. McGREGOR: That is right.

MR. STEWART: Which is only the first year of a series in each case. You cannot use the same wells for cost and the same wells for a percentage depletion. It is on a property-by-property basis, Mr. Chairman.

THE CHAIRMAN: So you can make an allocation with regard to each property?

MR. STEWART: You can but what we are talking about here is they have assumed these wells which they bring in are reasonably productive. These are based on averages that they are productive enough to result in growth depletion being greater than the cost depletion except in the first year.

MR. McGREGOR: Except in the first year.

MR. STEWART: Is that the substance of it?

MR. McGREGOR: Yes.

MR. STEWART: Looking at Exhibit 337, gentlemen, it is quite clear or it seems clear to me that the $21 million depletion allowance which the American company has very materially exceeds the depletion allowance which either of the Canadian companies have obtained.

MR. McGREGOR: That is true, Mr. Stewart.

MR. STEWART: You are suggesting, as I understand it a 25 per cent growth depletion without any limitations whatever, whereas the American system is 27-1/2 per cent growth with certain limitations; but I suggest to you that if your system were adopted for Canada in this hypothetical case, at any rate, the growth depletion again would very materially exceed the present Canadian depletion allowance.

MR. McGREGOR: Yes, it would.

MR. STEWART: Now, I would like to carry our Exhibit 337 a little further and in doing so to assume that these figures of taxable income are subject to tax roughly at a 50 per cent rate. Now, in the case of a non-integrated company if we assume the tax on the taxable income was $6,200,000, there would be an after tax income of $6,200,000 and if we added back the depletion which is also $6,200,000 we would have a total of $12,400,000 roughly.

MR. McGREGOR: In cash income?

MR. STEWART: Yes.

MR. McGREGOR: Yes.

MR. STEWART: If we follow the same technique in respect of the Canadian integrated company, the tax would amount to about $5,100,000; there would be an after tax income of $5 million. We add back the depletion of $8,500,000 and we would have a cash income of $13,500,000.

MR. McGREGOR: Yes.

MR. STEWART: As opposed to the $12,400,000.

MR. McGREGOR: Yes.

MR. STEWART: And then if we take the American company, if we assume a tax of $1,200,000 there would be a balance of $1,200,000 and if we add back the $21 million we would have a cash income of $22,200,000. Is that roughly correct?

MR. McGREGOR: Yes.

MR. STEWART: And then if we look at Table 15 again, we find that at a present worth basis, which you have determined at six per cent per annum in the case of the Canadian non-integrated company, the present worth of the tax is $1,745,000 but in the case of the Canadian integrated company and the United States company there is actually a net tax saving over the last 25 year period under this program.

MR. McGREGOR: Correct.

THE CHAIRMAN: This is the equivalent of a subsidy, I suppose, is it?

E-1

MR. STEWART: Well, Mr. Chairman, it obviously arises from the fact that in the early years these companies actually derive, if you like, very substantial tax credits from this program.

I take it that must be the situation, Mr. McGregor?

MR. McGREGOR: Yes, it is, Mr. Stewart.

MR. STEWART: I would like to ask you this --

THE CHAIRMAN: Before you leave that point, am I correct in assuming that in the case of a United States company, if one reduces the 25 years payment of tax to their present value -- and I think that is the way one ought to look at future payments always, -- one recognizes that the present value of these future payments is an asset of $685,000.

If it is an asset, surely it must be a subsidy? Am I missing something?

MR. McGREGOR: It results from the fact that we are in a position to take our exploration costs in the year they are incurred. It is like very accelerated capital cost allowances, I might say.

THE CHAIRMAN: But as one is never, under this system, going to actually receive a payment from the government at any time, I do not think, or reduce taxes otherwise payable, just how can we have an asset?

MR. McGREGOR: I think we have effected a tax saving, but as a result of our accelerated

allowance. I do not know that we have an asset.

THE CHAIRMAN: You cannot save more than the taxes that are payable.

MR. McGREGOR: But there is the deferred tax liability.

MR. MORRISON: Is not this the measure of the advantage of a United States company making an investment in Canada; the advantage accruing under this tax saving in the United States system? In other words, it is a measure of the present value of the United States tax saving.

THE CHAIRMAN: The United States company has got $685,000 in 25 years, with the present value of the deductions it is going to be able to make from future taxes after 25 years. Is that what you mean?

MR. STEWART: No. I should have thought that this figure relates simply to the 25 years, whereas the assumption here is that this American company has other income which will permit it to use up these charges, so that there is an actual reduction in taxes as they go along by virtue of these tax rules.

I should have thought, however, that the reduction was a fait accompli as you go along and that the figures relate to the 25-year period and not to any subsequent period.

MR. McGREGOR: Except to the extent that if you quit expending, the income of these expenditures would then become subject to tax.

MR. STEWART: Yes.

THE CHAIRMAN: I am still very confused as to what the American company has got in the present value of future payments which are worth $685,000 to it.

This is a successful operation; it has not been a losing operation, where it is helped through other operations. In a successful operation is it going to be able to reduce the taxes of something else by $685,000?

MR. MORRISON: Does not this mean that the present worth of the tax savings in the parent company, or the United States operation, exceeds the present worth of the additional tax that it will have to pay in Canada as a result of these successful operations?

Is not this what the negative amount of dollars and present worth means?

THE CHAIRMAN: We have an excess of savings over present worth on taxes, and therefore we have more savings than we have taxes. Therefore we have our taxes as a benefit rather than a cost.

MR. MORRISON: Not our taxes; through the United States tax system.

THE CHAIRMAN: Yes. They are a benefit rather than a cost. Therefore they have money received from the government in addition to a successful operation.

MR. MORRISON: Therefore their present

worth of investment in Canada is worth more than a similar investment by a Canadian in Canada. I think this is all it means.

THE CHAIRMAN: We have a nice little figure of $119,000 under Canadian integrated companies. Does that mean that company, by virtue of the tax system, has a present value of some future payments, which is an asset to it? Does it mean that the present value of savings exceeds the present value of its future tax payments?

MR. MORRISON: It has not a future taxes saving so much as that the investment today, or during the initial years, is worth that much more to the company than a similar investment by the non-integrated company.

THE CHAIRMAN: The present value is a real value and so long as money worth is higher, the present value is the genuine present worth of those future payments.

It seems to me that on this tabulation we have an asset of some kind of $119,000 which we would not have had if it had not been taxed, or am I wrong? This all comes about from the tax system.

MR. MORRISON: Tax in the future has some present day value, but I do not think we should miss the fact that the integrated company will pay $5 million tax and you have an over-all tax saving. We are talking about present value as against tax payments.

MR. HAY: An asset that can be produced and pay $5 million is worth more to a company than an asset that can be produced and will pay $6 million.

THE CHAIRMAN: I would have thought so; and if in the final analysis a company is going to pay $5 million, it cannot be in $119,000.

Perhaps we might go on, Mr. Stewart. I will think about this at lunch time. At the moment I am a little perplexed.

MR. STEWART: Would it be correct that during this 25-year period that your study relates to, roughly one-half of the petroleum in these wells will have been produced?

MR. McGREGOR: That would be a fair assumption.

MR. STEWART: So that if we project your study forward for the balance of the lives of these wells which were drilled during the 25-year period, there would be another $64 million odd of net production income?

MR. McGREGOR: I believe that would be correct.

MR. STEWART: And if we assume for the moment that these companies have become static during the second 25-year period except in the sense that they have been taking crude and gas from these wells -- petroleum substances -- they would have no more drilling and exploration expense in the second half of the operation?

MR. McGREGOR: No.

MR. STEWART: We might assume, I suppose, that their administration expense would in the second 25-year period be roughly the same?

MR. McGREGOR: That would be a safe assumption, I think.

MR. STEWART: The capital cost allowance would be pretty well negligible, I take it, since most of the capital costs have been recovered during the first 25 years?

MR. McGREGOR: Substantially, yes.

MR. STEWART: Then I suggest to you that it might be realistic to assume that income before depletion during the second 25-year period would be about $60 million. I get that by deducting from the $64 million the administration item of $3,700,000.

MR. McGREGOR: That would be close enough for these purposes.

MR. STEWART: Under the present Canadian depletion system would it not follow that in the next 25 years there would be a depletion allowance of one-third of $60 million, or $20 million?

MR. McGREGOR: That is correct.

MR. STEWART: Under the American system I take it there would be another depletion allowance of roughly $21 million?

MR. McGREGOR: Or slightly higher, I suppose. You are not using the --

MR. STEWART: Yes, it would perhaps be

somewhat higher. I do not know whether it is possible to determine this, but I suppose it might be $24 million?

MR. McGREGOR: I suppose it would be 25 years of our second depletion calculation, roughly the $70,000.

MR. STEWART: Supposing we say $3 million, which would bring it up to $24 million. Can we take that as a rough figure?

MR. McGREGOR: I think that would be close enough.

MR. STEWART: I would like to see just where this gets us. Looking at the Exhibit 337 again, we find that in the first 25 years the cash income for the non-integrated company amounted to $12.4 million. Now we have $60 million in the second period, less depletion of $20 million, which means taxable income of $40 million and tax of, say, $20 million.

So that in the second 25-year period, it would appear to me that the addition to cash income would be another $40 million, which would bring the cash income from the whole operation up to about $52 million?

MR. McGREGOR: That is correct.

MR. STEWART: If we take the Canadian integrated company we would again have an addition to cash income of $40 million, so that we would bring the total cash income in the 50-year period up to $53.5 million?

MR. McGREGOR: Yes.

MR. STEWART: In the case of the American company we had cash income for the first 25 years of 19. --

MR. McGREGOR: 22.2, I believe.

MR. STEWART: 22.2, is it?

MR. McGREGOR: Yes.

N. 22

MR. STEWART: 22.2. Should we not deduct from that 22.2 half of this $3 million in order to put them on a comparable basis?

When I refer to $3 million I am referring to the items which amount to $120,000 a year, which we assume has to be recovered through the depletion process. Those are the items at the bottom of page 9. So in the Canadian case all the costs are absorbed and we have a certain amount left. In the American case, should we not take off in the first 25 years half of this $3 million?

MR. McGREGOR: The $3 million? Those were the extra costs. Yes, I see -- the difference between our capital cost allowance and our drilling explorations.

MR. MORRISON: What about the cash flow?

MR. STEWART: These costs are not recoverable from certain depreciations. These amounts are expended by the companies. We get depletion in particular months. I had thought -- granted the whole $21 million comes in the 20 years, but if we wish in effect to reimburse ourselves for that $3 million do we not have to take it out of depletion?

MR. MORRISON: They will give us a tax reduction in the second 25 years.

MR. STEWART: Let us take the first 25 years. For tax purposes we have recovered the appropriate portion of the $3 million.

MR. MORRISON: The $3 million is not recovered in the first 25 years.

MR. STEWART: The $3 million represents the

-2

items at the bottom of page 9 -- capitalized costs totalling $118,000. Then at the top of page 10 you took a round figure of $20,000 which is $120,000 a year; and 25 times the $125,000 is $3 million.

THE CHAIRMAN: If you are going to add that depreciation -- which I think is your $3 million -- then you have also to add back the expenditure.

MR. STEWART: I do not want to add back; I am wondering whether we should deduct. We found as a result of our calculations on Exhibit 337 with regard to the first 25 years that what Mr. McGregor has called the cash income of the United States company was $22,200,000. The question which is on my mind is whether, if we are going to equate the American tax position with the Canadian tax position or the over-all Canadian position with the over-all American position, we should deduct from that $22.2 million figure one-half of the $3 million figure.

THE CHAIRMAN: Is it not already deducted within the charge for capital cost allowance?

MR. STEWART: No.

THE CHAIRMAN: It is customary to add back capital cost allowance, but if you add that back you must then take off the capital expenditure.

MR. STEWART: I do not think this particular $3 million figure will be recovered through capital cost allowance.

MR. MORRISON: On Schedule 7 perhaps the figures here under the heading "Calculation of Depreciation" -- my understanding is that in Year 25

F-3

you have a total amount of capital cost or depreciable assets of $9,310,000, and that you have claimed over 25 years at $6.7 million. Correct me if I am wrong. There is a difference of $3 million.

MR. STEWART: Mr. Morrison, what I am thinking of is not that. Does this $3 million of which I am speaking -- it was my impression that the $120,000 a year item of which I am speaking does not appear in your calculation for depreciation at all.

MR. McGREGOR: Capitalized land costs.

MR. MORRISON: I am sorry, yes. Those would not be allowable as a cost because they would be taken care of as depletion allowance.

MR. STEWART: They would only be recoverable as depletion allowance?

MR. MORRISON: Yes.

MR. STEWART: So it would be fair in the first 25 years to deduct half of the amount of the $1.2 million in order to equate the American result with the Canadian result?

MR. MORRISON: Included in the first 25 years -- I am looking at Exhibit 337 -- is the taxable income not $2.4 million. The income after tax is $1.2 million and to get the cash flow you add that to the $21 million under the depletion.

MR. STEWART: I do not get the real cash flow because we are not adding back depreciation.

MR. MORRISON: You add back $3.7 million.

THE CHAIRMAN: I think it is better to ignore the depreciation and to ignore the capital

expenditure, as you have done, Mr. Stewart.

MR. MORRISON: Yes, the same result is obtained.

MR. STEWART: Take the figure of $22.2 million in the first 25 years. In the second 25 years we were going to assume, I think, that the depletion was $24 million and that would be deducted from the figure of $60 million, leaving a balance of $36 million, tax of $18 million, so that the addition to the $22.2 million for the second 25 year period would be $22 million or it would bring the total up to $64.2 million, say $64 million. Is that close to the mark?

MR. MORRISON: That is right, $64 million.

MR. STEWART: Then my understanding is that if we take after tax income plus depletion for the whole of the lives of these wells, assuming that they all last for 25 years, the Canadian non-integrated company nets $52 million, the Canadian integrated company nets $53.5 million and the United States company nets $64 million -- all approximately.

MR. HAY: Yes.

MR. McGREGOR: Yes.

MR. STEWART: And if we think of the 50 year period as opposed to the 25 year period, the difference between the American depletion system and the Canadian depletion system is not as startling as if we look simply at the first half of the period.

MR. MORRISON: I think that is true.

MR. STEWART: Now I would like to ask you

this. In this program upon which we have embarked in this hypothetical study, what do you think the minimum capital investment, the minimum amount of capital required to carry out this particular program would be? In order to give you some light on my own thinking, because I have studied this a little bit, I should say that I observe that your maximum carry forward under section 83(a) in the case of non integrated companies is in year 9 about $6.899 million, or let us say probably $7 million. You would also require during the first nine years to make a substantial expenditure on depreciable assets, but you would have recovered a certain amount of that expenditure through the capital cost allowance.

I have been wondering whether one could carry out this program with an initial amount of capital which would be relatively small, which would build up during the first nine years to around $8 million or $8.5 million and could then be gradually recovered, if operations continued, and in due course would be completely recovered. What would you say as to that?

THE CHAIRMAN: Have you taken into consideration during the first nine years that there is a production income of something like $8 million?

MR. STEWART: Yes, but it seems to me, Mr. Chairman, that we have to take into account that as far as the non-integrated company is concerned one of the key lines is the cumulative section 83(a) carry forward which, at the end of the ninth year, hits its

peak of just under $7 million. That is after taking into account this production income year by year. So that over a period of years they would have to invest in this operation, I would have thought, at least $7 million plus an amount in respect of depreciable assets.

THE CHAIRMAN: I think the point is that they will spend during that year something like $15 million, and all throughout that period they are spending more per year than has been received, and in fact they have ended up by spending $7 million more than has been received.

MR. STEWART: It is more than $7 million because of the capital cost items.

Then, gentlemen, does it not come down to this, that with a maximum investment of $8 million or $9 million, which is perhaps a fairly short-lived investment up to that particular figure -- these companies can recover over the lives of the wells after recouping themselves for capital items, amounts which range from $52 million to $64 million?

MR. McGREGOR: Over 50 years?

MR. STEWART: Yes. It can be done on a 50-year basis?

MR. McGREGOR: Based on this, yes.

MR. STEWART: In other words, whether we have the Canadian depletion system or whether we have the American depletion system, we recover over the lives of the wells many times the amount of our capital investment.

MR. McGREGOR: Yes.

-7

MR. STEWART: If I may revert for a moment to your principle submission, page II-38, you refer there in paragraph 109 in particular to the high risk nature of the industry and to the possibility that the risk element is increasing. You say that the prospects of success may be more remote and that the industry needs stronger incentives than it has had in the past.

Having regard to this example which you have given to us and which is, granted, as I understood from what you said at the beginning put forward as a realistic example, can you reasonably say that the return which the industry is realizing on operations of this character is not a reasonable return?

MR. MORRISON: Mr. Stewart, my interpretation of your figures here is that you come up with approximately $50 million over 50 years, $1 million per year. Then we take off everything before we get cash flow plus something for working capital. In other words, this is about 10 per cent.

MR. STEWART: Ten per cent of the tax?

MR. MORRISON: That is right. It is an average of 10 per cent of the tax, and this is cash flow we are speaking of.

MR. STEWART: It is not quite cash flow; we have left out depreciation.

MR. MORRISON: We left out the depreciation because we made an investment.

MR. STEWART: Fair enough.

MR. MORRISON: Some survey was done on other extractive industries and cash flow ran at about

15 per cent, as I recall. So this puts us at about two-thirds of industry's classification. It includes every industry in Canada, whether a refinery or a shoe factory. If the company is not to take into consideration what it pays in dividends, if it had kept all this money it would have recovered many times this capital investment.

MR. STEWART: The figure of nine or ten million dollars is not required as a long term investment for this particular operation.

MR. MORRISON: Is it not true of any industry? The only ones that would require a longer period of investment are perhaps some public utilities. The average manufacturing industry is, I believe, a shorter period of time.

THE CHAIRMAN: A shorter period of time for recovering their capital? The fixed assets you are speaking of?

MR. MORRISON: Recovering their capital. I am taking into consideration all profits paid out in the form of dividends, because none of this is brought in here.

MR. STEWART: The thing that occurs to me about this, Mr. Chairman, is that this figure of eight, nine or ten million dollars, or whatever it may be, is built up over the period of ten years -- nine or ten years. Presumably the capital must have been arranged for before the program started but the amount actually invested scales up for the first nine years and then it would appear from these figures that it

F-9

can scale down again quite sharply, so whether Mr. Morrison's approach of taking $1 million on a $10 million investment is the appropriate one, I am not sure.

THE CHAIRMAN: Mr. Stewart, if what you say would be the general practice, why would this industry generally have financed in such a way as to redeem its securities that it has used to raise $9 million? Why would it not have established capital structures which are generally a mixture of common preferred and common debentures -- the $9 million to build up the money needed and then be redeemed in the following few years according to the cash flow, making the equity really the only investment behind it, but representing the entire ownership? That has not been the practice, I think.

MR. STEWART: I would like to put it to these witnesses that what we have been doing at the moment is perhaps unrealistic in that we have been assuming that you can look at this 25 year, ten wells a year program in isolation. But, of course, I was careful to say when I got into the second 25 years that we will assume, for what it is worth, that this particular company does no more drilling or exploring, it just sits there with its producing wells and lets the production come through. Of course, this does not happen in practice and I take it particularly that it has not happened in Canada since 1947, because we still have not got through the first 25 years.

MR. MORRISON: All I was trying to suggest

for comparison was that if we bought a 50 year Government of Canada bond at five per cent interest, after 20 years we would not suggest that we would have no further investment because we have got back five per cent for 20 years and for that reason we should hand our bonds back to the government and say, "Thank you, we have our money back and we don't need any more return on our original bonds".

MR. STEWART: I accept that.

THE CHAIRMAN: I do not think, Mr. Morrison, that Mr. Stewart thought the profits of the industry were excessive. I think he asked you if this indicated that the profits were low.

MR. MORRISON: I think they are low because I feel this rate of return of 10 per cent must be compared with other industries. The particular study I am thinking of in regard to extractive industries is 15 per cent. I would not want it to be felt that because we have our money back five times over that we have made 500 per cent on our investment.

THE CHAIRMAN: No, I think we all understand that.

MR. HAY: I think we must be careful not to confuse the fact that this is to demonstrate how the taxes operate and should not be compared to what the actual operations in the industry are or have to be, because this is an average. The average is made up of wide variations of success and failure, and by far the majority, in numbers of companies involved, by far the excess is of people who have not been

successful.

MR. STEWART: I think you did tell me at the beginning that this was a reasonable example to consider.

MR. HAY: This is a reasonable average on a statistical case of 25 years of all the wells we have found, but for the industry to find all the wells it needs, we would have to think of the vast majority of people who are in small operations and who, in order to find money, have to find oil and return the money that they borrowed or raised sooner than this example would show. This is a tax situation for the successful people.

-1

This is a taxation situation for successful people who are able to drill 10 wells in a long time. In practice, there are not too many companies that can look at a thing like that. You have to find oil quickly or if they don't find it they are out of business so if the success of the industry is to meet the demand for crude oil, this should not be taken as what we are faced with, the problems we face.

MR. STEWART: No, but you have taken here an average production income, average expenses, both operating and capital and it would follow average depletion.

MR. HAY: Yes, I agree with that.

MR. STEWART: Well now, I would like to go, if I may, to another document which I sent your Mr. Stuart and said that I would ask you to comment on during these proceedings.

This is a chapter with regard to the taxation of income from natural resources which appears in a pamphlet entitled "The Federal Revenue System, Facts and Problems, 1961" and consists of material assembled by the Committee Staff for the Joint Economic Committee of the Congress of the United States.

Now, this chapter which consists of pages 89 to 101 of this pamphlet relates, of course, to the natural resource industry as a whole but it does deal with the petroleum industry to some extent. It deals with it, and needless to say, in the

G-2

American context and the purpose of my questions will be to get your comments on the applicability of certain of these points to the Canadian picture.

Mr. Chairman, I am afraid I have only one extra copy of this.

THE CHAIRMAN: I think we can listen to you as you go ahead.

MR. STEWART: Now, I would like to start at page 93 where they begin to deal with the issues in the taxation of income from mineral resources. The first subheading under that main heading is "Effects of present tax provisions on the allocation of resources". And they say there that one of the major criticisms directed against the present tax treatment of income from extractive industries is that it encourages serious misallocation of resources.

They go on to refer to the fact that the after tax rate of return in these industries is more or less average but that the pre-tax rate of return is low and they say that it is suggested that the preferential tax provisions which these industries have in the United States are in fact a subsidy which promotes over-investment in the extractive industries.

And then they go on in the next paragraph and develop this proposition. What would your comment be on this, as it relates to Canada?

MR. SMITH: I think that I can comment on that, Mr. Stewart. I think probably it would be

no more than obvious to say that with respect to effective taxation that it alters the allocation of resources. If one looks solely at taxation, you could conclude that this leads to misallocation of resources. We talked about this. We thought in perhaps proper terms, you cannot single out a single factor of taxation when you are discussing allocation of resources in the economical sense; that there are, in fact, a whole range of devices in the form of a wide assortment of government policies, whether they are tariffs or subsidies or they are special assistances somewhere else and if perhaps you have to view the whole complex and simply conclude that each of these policies in its own way, for its own purpose, has an impact on the allocation of resources.

To reach the net judgment of one is not really a very substantial conclusion. Again the whole fabric of the policies they have has resort allocation effect.

I think if perhaps you extend the thinking and say dealing with taxation alone, if you infer from this line of argument that there should be identical treatment of taxation in order to avoid misallocation, this would break down too because it is recognized, I believe, that there are inherent characteristics and practical considerations that affect the comparability of various forms of economic activity.

In other words, you do not get a perfect -- whatever that means -- allocation of resources

under identical taxation -- true -- because of other inherent factors, I would say, whether those factors are risks or location or growth prospects or whatever.

The net of what I am saying really comes down to the fact that it must be true that given a certain type of tax treatment this will have an effect on the allocation of resources but it is improper to conclude, giving consideration to this factor alone, that therefore there is an undesirable over-all misallocation of resources. You would have to look at the impact of each thing, each policy which affect allocation of resources, in my view. Does that answer your question?

Before you go on --

MR. STEWART: Well, I think the Chairman may have a question.

THE CHAIRMAN: I have a question on that score. It seems to me, Mr. Smith, when you admit that it does affect allocation of resources, and I think you must admit it -- the tax system seems to be designed to do just that.

MR. SMITH: Yes.

THE CHAIRMAN: If it is designed to do that, it is in the wisdom of our lawmakers important to do so.

MR. SMITH: Precisely.

THE CHAIRMAN: Why not simply say, "Yes, it affects allocation of resources". I don't think misallocation is quite the right word.

MR. SMITH: No, I don't believe it is

because it is a judgment policy which is made.

THE CHAIRMAN: Somebody has decided and it has been placed in our law that the allocation of resources will be affected by these tax concessions because at this time or at the time the law was imposed, it was thought to be in the national interest.

MR. SMITH: Yes, that is right. I think, therefore, you sort of come to the general conclusion that the ultimate determinations here are policy determinations rather than equity considerations which I take to be implied in the narrow interpretation of the effect of taxation on this industry. This is a connotation of inequity or perhaps not inequity, it is only leading to misallocation whereas indeed the appropriate policy may lead to the conclusion it is the allocation of resources that you want to encourage.

THE CHAIRMAN: I think so.

MR. SMITH: Which is quite a different conclusion.

THE CHAIRMAN: As I say, our job first of all is to try to establish how the tax burden of the nation may be spread out as fair as possible throughout the taxpayers and then, beyond that, to consider the adjustments in that tax burden, having regard to the useful economic or social matters that the tax system endeavours to encourage.

MR. HAY: A further comment may be made

G-6

in this connection. There is this statement made in the part that you read that this allocation was -- or this tax arrangement promotes over-investment in the extractive industries. In actual practice at the present time that is not the case.

Over-investment implies, I presume, over-production and it is true that for a short period the industry had and even today can produce more than it can sell. This is short range. This is the immediate situation. As I tried to point out in my opening remarks it can produce this, but looking at the industry in the time period we have been talking about, that is up to 1970, we are not able to produce, on the basis of the oil and gas we need, from what we have found today sufficient to meet the market that Canada can supply and will have to supply. We need more money so the question of over-investment does not lead to enough investment yet or a means of finance or money that we need to meet the demand.

THE CHAIRMAN: Of course, that is implied in my own thoughts as I express them to you now as I think at the moment. They may change tomorrow but if this is designed by the government to encourage expenditures in this industry, just as soon as this industry is in balance with other industries, such incentive should be withdrawn and the industry will pay its full share of taxes the same as anybody else.

MR. SMITH: Yes, what would be the test of in balance, Mr. Carter?

THE CHAIRMAN: I don't know.

MR. SMITH: Profitability, I suppose, or something of that nature. Is that what you are saying?

THE CHAIRMAN: I suppose that one could say this is getting the resources that it needs to expand with other industries that are getting the resources they need -- not that it is getting all the resources it needs, because nobody does that, but getting its fair share.

MR. SMITH: I think in order to get its fair share that it surely must be able to offer comparable profit prospects. This would be fair, I should think, otherwise, it is not likely to be able to get its fair share.

MR. STEWART: Well now, in the first complete paragraph on page 94 of this publication they say that the preferences of the extractive industries may be based on the risk factor and then they go on to say that these risks affect the small independent operator particularly and that depletion allowances were first introduced to help the small prospector but that the real beneficiaries of the depletion allowances now are the large corporations, who do not really need them because of the size and diversity of their activities.

So that they suggest that the distribution of the incentives to special depletion

allowances is quite different from that conceived in the original provision.

MR. SMITH: I will start, if I can. Perhaps Mr. Hay will supplement it. I don't know if I have the complete answer, by any means. I think perhaps there are certain things to be conceded in terms of the obvious fact that the small operation, on the basis of probability and so on, faces greater risks.

Perhaps you could look at the risk also on an industry basis and in the time sense as opposed to looking at any given time and the various sizes of units.

I think really it is part of the economic section of the brief that we infer historically particularly with the exploration and development sector, that there is evidence of increasing risk in the sense -- not in the percentage sense -- but rather in the sense of committing funds with a view to obtaining an adequate return. The prospect of success here has evidently and historically deteriorated so that in this industry sense there is an increasing risk.

To say that a device is directed to the greater advantage of the large scale units is perhaps not much more than saying that all through the industry there are advantages to large scale but where one wants to go beyond this and suggest that this is an advantage that comes with scale and should be equalized is a pretty major step of the

general kind that is to be taken when it is concluded that there is something undesirable about scale.

Why would you want to do this unless it was assumed in the interest of somehow equalizing opportunity at a cost, I would say, given the fact that the over-all industry faces what we would say would be an increasing risk prospect?

MR. HAY: I think the industry wants and feels the need of having the small exploration companies in business and I think one of the reasons they are in business is because they take risks and they need help to take those risks.

I think that a tax structure should be designed to see that such is useful for small companies to stay in business.

The size of the company in relation to the risk it takes on a single development, where it has spent a large proportion of its resources and energy on a single place can be much more catastrophic for it than the larger company, which have a diversification of interest in the industry and in the world, if we want to go that way. This is important to Canada and to finding new Canadians in the industry and new oil wells and reserves.

THE CHAIRMAN: The question is whether there is not a very substantial difference in risk between the Canadian small operator and the big one. It seems to me the risk is entirely different. I can understand it in regard to the small man. I find the greatest difficulty in regard to

the large integrated companies having the same risk. A company that has 19 years oil in the ground and 30 years of gas reserves can well afford to go for quite a few years without producing anything and still pay dividends and be very successful. I can't think of anything being much more secure,even the banks. They only have a moderate reserve.

MR. HAY: Except this point, Mr. Chairman, no company is able to draw on its reserves of crude oil in relation to its needs. It has to draw in relation to the total market for the crude through proration,so that having 19 years in the ground does not mean it is going to protect them in relation to its exploration activities it must engage in.

THE CHAIRMAN: If he ceases development right then and there, a large company with 19 years of oil in the ground will be very happy for 19 years and then go out of business making a vast amount of money during the 19 years or would the oil not come in? I don't know very much about it.

MR. HAY: He would not be short of oil for manufacturing operations because the total market available is prorated among all the wells. This is in Alberta, but among all the wells that can produce so everybody gets oil regardless of whether there is no oil or three times as much oil as they need.

THE CHAIRMAN: I think I am correct -- if a company had very substantial reserves and fails to find any more wells they would still reap

substantial revenues for quite a long time, not as great as if they had not tried to find any more wells.

MR. HAY: That is the point and the way to take the greatest advantage of the tax situation is not to explore, as it exists today, if you want to make a profit.

THE CHAIRMAN: I get your point.

MR. HAY: My point is to maintain our reserves and improve them to get ready for the future. I think that is the fallacy of this situation here. We are talking about a company going out of business. We want to get to the right principle.

MR. MORRISON: This study indicates the companies that get the most depletion allowance. It does not indicate whether they get a greater portion of the revenue than smaller companies. It seems to me these same statistics can be used to prove that large companies are inefficient because they spend the most money on operating expenses.

MR. HAY: It was my impression that what the author of this was getting at was the point that the Chairman has mentioned that large companies as stated here can really self-insure themselves against prospecting and from exploration and drilling risks. They are carrying on in such a scale that the laws of averages mean more to them than they do to the little fellow.

MR. SMITH: This more than proves the

point as you observe that the law of averages at the industry level seem to be getting worse so that it is not as if the law of averages is fixed for the over-all risk factor.

MR. MORRISON: In this context it applies to all sizes of industry equally. The large companies eventually become small and the small ones become the large ones by giving an advantage to the small company.

THE CHAIRMAN: Well, the question I think that has been raised here is whether a preference such as depletion should be made available to everyone or whether it should be confined to a small person and presumably removed if that person gets out of that particular category.

MR. MORRISON: The only point I wish to make in this is that the policies are related to investment. Really no conclusion can be drawn as to the relative effect to a small company or large companies.

THE CHAIRMAN: There is a precedent for this, on the first $35,000 of taxable income, there is a low rate charged.

MR. MORRISON: My understanding of that is it was to eliminate double taxation to the small independent businessman to a large extent.

THE CHAIRMAN: Well, it gives a preference to the small man.

MR. MORRISON: Yes.

COMMISSIONER PERRY: I have an idea that

G-13

to attempt to prove risk is a very speculative sort of concept. I think on the statistics that probably the retail trade is the riskiest trade in Canada, certainly it has the highest incidence of mortality so this really raises the question as to what is the basic concept of risk. Is it the possible incidence of failure or is it the amount of money at stake if there is a failure or is it your ability to meet failure if you have one? Generally when you buy insurance the agent does not ask you how wealthy you are. He charges you the same premium as the poor man so that you can say in one sense risk should not take into account your reserves; yet it is quite obvious eventually if you are operating on a broad enough scale you can self-insure yourself. Your reserves are so evenly spread they almost cancel out.

MR. SMITH: You mean the point that you can reduce your risk and yet we are saying the risk in the most general sense has evidently increased. You can always carry with you, if you like, this higher degree of insurance that goes with size and environment where a thing is becoming increasingly risky.

COMMISSIONER PERRY: That was what I was saying. We would have to define this concept a good deal more than we have to discuss it intelligently.

MR. HAY: That is true. I do not know how you arrive at a measure of risk, just quickly.

One measure may be the apparent ease or otherwise with which you attract capital and money to carry on your operations and we are very soon getting into an area there as a country as to how we are able to attract money to look for oil in Canada as against the opportunities that companies have to look for oil in other areas. This then becomes an important thing for this country to compete for money to maintain our resources.

COMMISSIONER PERRY: What you are saying is that the two factors come in here, not only the chances of failure are high but the stakes are high.

MR. HAY: That is true. Therefore we get into a strange area where equities look good but the incidence of people who are staying and looking and the people who have to leave and the people who find out is another study. The incidence of failure and the incidence of great stakes are perhaps the most attractive thing we have for certain kinds of capital.

THE CHAIRMAN: Perhaps I have the happy answer to this. In those cases where price earnings ratio are less than 10 we should allow depletion. In those cases where it is more than 10 we should not allow depletion.

MR. HAY: I think there are a lot of ways to look for a solution.

MR. STEWART: Well now, gentlemen, I think I will skip over to page 96 unless you have any

G-15

comments you would like to make on the intervening argument.

In the last paragraph of page 96 where they are dealing with considerations of defence requirements; I suppose, in this country we think to some extent in terms of continental defence. They indicate here that these tax rules for the extractive industries have been justified because of the importance of the products to national defence. This point is then made that if we require these products for national defence reasons then what we ought to be doing is to conserve the products rather than expending them, and they point out that the percentage depletion, which is one of the things you gentlemen advocate, has the effect of encouraging the drawing down of reserves rather than conserving reserves.

They go on to suggest that in the absence of a percentage depletion the price of mineral products would rise with the result that consumption would be more limited and our reserves would be maintained. What do you say about that?

MR. HAY: I wonder if I can go a step further back. I believe on page 94 there is a suggestion that with "neutral tax treatment for the extractive industries, the relative priority of mineral output would be expressed through the market mechanism in the price of such export as compared to that of other industries." And I think it indicates that if it costs more to find this we should charge more for it.

In Canada today we are in the position where we do not think we can raise the price of crude oil. There are several things that might be done, but we are selling on a world market and we are depending, and will continue to depend, on supplying the market in the United States that is now served by pipe lines and now being served. In order to continue to market in that area, we have to look at a continental price, as you refer to it. Also, I think we should point out that in Canada about 45 per cent of our requirements for crude oil are supplied by the import of crude oil, imported on a world market.

Here again, I do not think we can think in Canada about raising the price of our crude oil because it costs more, because we would lead to a good deal of confusion if we tried to charge Canada a higher price for crude oil, and the areas we supply, with the consequent change in the price of products, and as against the price of products which would be charged for products made from cheaper crude.

I do not think we can successfully raise the price of our crude products.

MR. STEWART: Well, Mr. Hay, the argument of this book appears to be that in the United States it is realistic to consider leaving prices to the normal market mechanism. You have suggested that these prices are world prices, and I think this is the traditional view.

I suppose what you say as far as Canada is concerned is that whether or not it is realistic for the United States to consider steps that might have an effect on domestic prices in the U.S., it is not realistic for Canada to do this?

MR. HAY: I believe that is right, yes. The question of defence and just using less when we need more for defence purposes -- I think that was the suggestion in this -- again it gets into the time factor. We do not have time to find the oil that we need for defence. We need to find it now or start looking for it now. You cannot stockpile crude oil or gas.

--- The hearing was adjourned at 12.55 until 2.25 p.m.

AA-1

--- Upon resuming at 2:30 p.m.

THE CHAIRMAN: Mr. Stewart, we are ready to commence now.

MR. STEWART: Gentlemen, I would like to go back to this publication we were looking at before lunch and get your reaction to two or three other points which are made in it. I will start at the top of page 97 where they begin to deal with equity and revenue issues when we are considering the taxation of income from mineral resources.

In the first paragraph on page 97 they say that the opponents of the present treatment of the extractive industries claim there is no theoretical justification for treating mineral producers differently from other taxpayers through depletion allowances, or through what amounts to our Section 83A, and they allege that in the extractive industries taxpayers can recover tax-free virtually the full amount of their investment often in the year in which the outlays are made, and subsequently claim percentage depletion allowances which bear no relation to the amount of their investment and, accordingly, they say the law may permit tax-free recovery of capital costs several times over.

Now, we found this morning in the hypothetical case that you put on the 50-year basis the depletion which is deductible under either the American system or the Canadian system does amount to several times the capital costs or the amounts

invested in the enterprise. What, if any, comments have you on this particular paragraph?

MR. SMITH: Well, I do not know that I can really speak for the group, particularly. I do not suppose there is a theoretical justification that can be quantified in any way. There might be theoretical justification associated with risk, or some such thing, but I am not sure there would be much agreement on how you would quantify such justifications as there might be. It seems to me to come back again , as we were saying this morning, to questions of policy rather than theory and the objectives of the policy.

MR. STEWART: Then, going on to page 98, and in particular to the last complete paragraph on that page where they talk about the revenue effect of this type of treatment, they suggest that the loss in taxation by virtue of these preferences in the United States at the time this book was written might well exceed $1,400 million a year from corporations alone. That, of course, does not relate only to the petroleum industry, I suppose; it relates to the extractive industries as a group, and, of course, in Canada we do not deal with the amounts that they do in the United States, but I suppose there can be little doubt that the cost of these preferences to the Canadian revenue would be very substantial.

MR. SMITH: Well, we do not have any knowledge of the amounts either. I suppose it is

reasonable to assume that they are substantial.

THE CHAIRMAN: Please keep your voice up, Mr. Smith.

MR. SMITH: I am sorry. I have just acknowledged that they probably are substantial, but we do not know the amounts either.

THE CHAIRMAN: Thank you very much.

MR. STEWART: On page 99 they relate to some proposals which have been made for tax revisions in the United States, and they say that the most extreme proposal calls for complete elimination of percentage depletion and the limitation of deductions for capital recovery to the adjusted basis of the property.

I do not think I will bother asking you to comment on that proposal, but I notice that at page 100, in the third complete paragraph -- perhaps I can go to the fourth complete paragraph first, and then to the fifth. They say it has been suggested in the United States that the basic provisions remain the same but that the rate of percentage depletion be reduced from 27½% to 15%, and that the net income limitation which is now 50% be reduced to 25% or 30%. Now, you are suggesting, of course, a 25% rate of percentage depletion with no limitation at all. With that background perhaps you could let the Commission have any comments you have on these particular paragraphs.

MR. SMITH: Well, are you concerned with the question as to why they should be a particular

rate?

MR. STEWART: I am looking at this, Mr. Smith, from this point of view; we have a rate in Canada of 33-1/3% at the moment based on production costs. You are suggesting a 25% rate which you suggest corresponds to 33-1/3%, although I am going to put it to you a little later that this depends on the percentage of income which is applied in exploration, but we have also looked at the example that you gave us this morning. We have found that the American rate of 27½% produces a great deal more depletion, at least in the early years, than the present Canadian system. We have found what the cash return on this hypothetical investment of yours appears to be, both under the Canadian system and under the American system -- a rate of 27½% of gross, which is some 10% higher than your 25%. Now, do you consider if we were going to switch in this country to a system of gross depletion the rate of 25% can be justified?

MR. McGREGOR: Mr. Stewart, I think the study, amongst other things, indicated that there was a competitive advantage to a United States company as a result of the depletion allowance they have in the United States. The 25% rate adopted by the Association stems from two factors; one is that there is presently a 25% allowance on gross royalties and, secondly, if a company has no exploration charges against its production income then the 33-1/3% net rate is quite similar to 25% gross.

We have heard statistics on the effective rate of $27\frac{1}{2}\%$ gross in the United States versus 50% of net and, as I understand, it might run around 23 or 24%, or something in that region.

MR. STEWART: I am afraid I lost the last part of that. You said you have seen statistics?

MR. McGREGOR: I cannot say I have seen statistics, but in discussion with people from the United States it all seems to result in an average rate in the order of 25%, although I have heard of something down as low as 22% or 23%. The suggestion is that 25% rather than $27\frac{1}{2}\%$ not only recognizes the rate as at present in the regulations, and corresponds generally to the equivalent of 33-1/3% under present conditions, but it eliminates a lot of detailed administrative work in calculation. As I indicated earlier in answering the questions of the Chairman, one of the things that concerns us with respect to depletion is that it should be allowed as a first deduction instead of as under Section 83A which involves two variable factors in the same calculation. 25% overcomes that particular difficulty. It is also intersting to note that 25% of this hypothetical example comes to $16 million as against $21 million in the United States. That is offset to some extent by the $3 million that is not allowable in the United States. In other words, you look at the $16 million as against $18 million.

MR. STEWART: We also have to take into

account, I take it, that in Canada at the present time if you combine the net effect of drilling and exploration and capital cost allowance the Canadian system, again referring to your example, is $5 million more favourable to the taxpayer than is the American system.

MR. MORRISON: Capital cost allowance?

MR. STEWART: If you take the combined effect of the drilling and exploration deduction and the capital cost allowance, the drilling and exploration is about $6 million more favourable to the Canadian, and the capital cost allowance is about $1 million more favourable to the Americans, so that there is a net advantage of $5 million in those two items to the Canadians.

MR. MORRISON: Sir, I do not know where the $6 million comes from.

MR. STEWART: It is a figure of $5.8 million actually.

THE CHAIRMAN: You add the first three items. In the case of the Canadian it is $45 million, and in the case of the American it is $40.8 million.

MR. MORRISON: It seems to be on balance in total. They come to about the same. I do not know whether it is a coincidence or not -- perhaps it is a coincidence in this particular example.

MR. STEWART: If this proposal on page 100 that the net limitation be reduced from 50% to 25%

AA-7

or 30% were carried into effect I suppose that that would reduce the effective American rate substantially below the 23% or 24% that you referred to?

MR. MORRISON: I am sure it would, but I hope, on the other hand, that the price of oil would remain sufficiently constant because we are again in a competitive market.

THE CHAIRMAN: Is this the case at which to find some rationalization in this reduction from gross? I am finding it difficult to see why we should deduct anything from the gross income -- certainly without limit. I can understand if one wants to encourage the industry that it is a good idea to reduce the tax rate, or I can understand that if you want to encourage drilling you might do the same thing as you do with respect to research, and that is allow 150% of the drilling expenses, but I cannot understand why 25% should be deducted from the gross income which, in many cases, will cause the companies who are earning profits not to be taxable at all.

MR. STEWART: Is there any justification left for this, gentlemen, except the simple one of incentive?

MR. HAY: Well, it is an incentive.

THE CHAIRMAN: But not as good a one as it would be if we knocked off all taxes. We have to strike some percentage that is fair to everybody right down the middle. To encourage incentive the simplest thing is to say: "No taxes at all".

MR. MORRISON: That is why we feel this is

A-8

the most effective incentive because it is related directly to the results obtained rather than to the spending of money. This particular question has come up, I know, at a previous hearing, so we have prepared some illustrative figures here expressed in percentage of royalties. Perhaps I might ask the Secretary to distribute these.

I believe we have already mentioned the convenience of the rate and the simplification of its application as against the present rate, and as against the United States rate which is higher but which has limitations. This schedule -- perhaps you would like to mark it as an exhibit, Mr. Chairman.

THE SECRETARY: It will be Exhibit 339, Mr. Chairman.

EXHIBIT NO. 339: Document showing various calculations and signed "D.J. Morrison, January 15, 1964"

MR. MORRISON: This assumes in Case I that we have an exploration expense of 30 cents per barrel of production in addition to development costs including capital cost allowance, which are handled separately for the purpose of simplifying the illustration. In the second case this has been increased to 63 cents per barrel, and I will be the first to admit that the figure of 63 cents has been specially selected to illustrate the full significance of the 200% allowance which, I believe, was mentioned at an earlier hearing.

The profit was recalculated on the basis of a different allowance here, and in each case it shows the net change in profit on the third from last line as a result of the increase in the exploration expenditures. This reduction in profit is related to the additional exploration expenses incurred.

THE CHAIRMAN: You are going too fast for me, I am afraid, and I suspect that the other Commissioners are in the same boat. You have Case I and Case II.

MR. MORRISON: That is right.

THE CHAIRMAN: Case I comes down to net profit after development expenses?

MR. MORRISON: In the first case it is 64 cents net after deducting 30 cents for development and 30 cents for exploration, and applying income tax under the present provisions.

Case II does the same thing for a 25% gross depletion allowance ---

THE CHAIRMAN: I think you should have said column 2 and not Case II.

MR. MORRISON: That is right; I am sorry. Columns 3 and 4 deal with two rates of exploration allowance which might be considered for comparison.

THE CHAIRMAN: Yes, I see.

MR. MORRISON: Case II increases the exploration expense from 30 cents to 63 cents, and re-determines the profits under each of the four columns.

THE CHAIRMAN: The only difference between Case I and Case II is that in Case I we have spent 30 cents on exploration, and in Case II we have spent 63 cents?

MR. MORRISON: That is right.

THE CHAIRMAN: And what does all of this show?

MR. MORRISON: The reduction in profit by spending the additional 33 cents is 22 cents in the first case and $16\frac{1}{2}$ cents in the second, $8\frac{1}{4}$ cents in the third, and there is no reduction in the final case. This means that in the first case exploration costs 66-2/3 cents on the dollar spent, and in the third case it costs 25 cents on the dollar spent, and in the last case it does not cost anything so you may as well spend the entire amount which would otherwise be taxable.

THE CHAIRMAN: The government pays the whole thing?

MR. MORRISON: That is right, and that is why we think it is perhaps a more reasonable allowance. It gives a higher rate of return in some cases, and for that reason it is also more effective.

THE CHAIRMAN: That is the reason why you say that we should believe that this -- what you mean is that 25% of gross is the fairest one? Is that what you are saying?

MR. MORRISON: Yes.

THE CHAIRMAN: And that is column 2?

MR. MORRISON: That is right. My understanding of the research allowance is that all expenditures have to be approved by the National Research Council. I think that this might be a very difficult administrative problem. It would be difficult if the National Energy Board had to approve every expenditure.

THE CHAIRMAN: I do not think that is the case if you qualify under Section 83A. You have to pass the Section 83A test.

MR. MORRISON: That is the present case, but I was making a comparison with the incentive allowance for research in respect to which I understand that every expenditure has to be approved.

THE CHAIRMAN: Why do you assume that has to be the case? You know what the drilling expenses are because they are described in the section.

MR. MORRISON: Without a similar administrative problem you will find that perhaps it might cost 25 cents on the dollar, and you might have indiscriminate spending. That is the other aspect -- indiscriminate spending.

THE CHAIRMAN: Yes.

MR. STEWART: This new exhibit is helpful in that it indicates the result of going to an exploration allowance as opposed to the present or modified depletion system, but coming back to the difference between 33-1/3% net depletion and 25% gross, and to these figures on page 100 of this book, do I take it that you have no further comments

on these percentages -- that is, on the suggestion that is made here that the 27½% should be reduced to 25%, and that the 50% net income limit should be reduced to 35% or 30%?

MR. HAY: I think it is difficult without doing some work on it to see what the effect would be, and to see how it would influence the prospect of obtaining enough money to further exploration.

MR. STEWART: If you think it is worth while to consider this further, Mr. Hay, and if you have any comments you would like to put to the Commission, perhaps you would send them in,

MR. HAY: Would that be in order? We would be glad to give you any alternate suggestions there may be to what we are giving you now. As a matter of fact, we would ask for that privilege, if we can have it.

MR. STEWART: I do not want you to think that the Commission or I are suggesting this type of net income limitation. This is something that appears in this book, and it would be interesting to know what the effect of it would be. It is not our suggestion.

MR. HAY: I appreciate that. There have been suggestions about eliminating depletion for a good many years, and by people who are not in the oil business.

MR. STEWART: I suspect that whoever

wrote this book had some knowledge, at least, of the taxation of the extractive industries.

MR. HAY: Yes, of course they did.

THE CHAIRMAN: Mr.Stewart, before we put this schedule away I would draw attention to the difference between the first two columns. The main difference is in the figure which is referred to in Case I and Case II as "Allowance". In the first column it is a third of the figure before it, which we know very well. It is 32 cents out of 96 cents. But, when you go to the next column it becomes 51 cents out of 96 cents. If you go down to Case II, where instead of having to spend 30 cents on exploration you spend 63 cents, the allowance goes up. It is 51 cents, which is five-sixths of 56 cents. And our tax comes down from 21 cents to 6 cents. But, of course, that is a reward for -- we save 15 cents on tax in one case as against the other, or we pay less tax at the bottom than we do at the top by 14½ cents because we have spent another 33 cents on exploration. It makes a very material difference. That is what I am trying to say.

MR. MORRISON: It serves to bring out what the effect of the present provisions are on the cost of exploration.

MR. STEWART: Also at page 100 they make another suggestion to which I would be interested in having your reaction. They suggest we should scrap this percentage depletion altogether and continue to allow exploration and development costs and then

exempt the companies in your industry from tax completely on the first three years' income, and after that allow them no capital recovery allowance of any kind. Now, in Canada, as you know, in the mining industry we have a three-year exemption plus exploration and drilling, and depletion of a sort. In your industry we have not got the three-year exemption, but here we have a suggestion that you would be adequately looked after, or would be adequately looked after if you were in the United States, if depletion were replaced by a three-year tax holiday. Have you had an opportunity of considering that?

MR. HAY: I do not believe that I am able to offer any ---

MR. McGREGOR: I do not know that the two industries are really comparable under the situation there.

MR. STEWART: Do you mean the American industry and the Canadian industry?

MR. McGREGOR: No, the mining industry.

MR. STEWART: Let us just deal with petroleum here.

MR. McGREGOR: The history of this industry is one of expansion, and you are just not running into income in your first year.

MR. STEWART: I thought that that might be the answer. Let me go to page 101. There it is suggested that the Americans eliminate all these elements of preferential tax treatment, and that

the natural resource industries be given non-tax incentives such as subsidies, price supports, and so on, with the thought that that alternative type of incentive or subsidy would reveal the real cost of what is being done to the public, the suggestion here being that these tax benefits are of such a type that they receive little public attention. What would you say about that?

MR. McGREGOR: I suppose the government could make them public.

MR. SMITH: I think there might be one other consideration. I suppose if you are simply considering the range of assistance devices that are available it does not greatly matter by which assistance devices you choose to provide assistance, but there may be questions in respect of the international trading aspects of the industry, and possibly a case might be made that certain types of assistance devices would invite retaliation or some sort of response from the other side, where others do not. We could imagine that with respect to price support or, perhaps, even subsidy, by virtue of the fact that they might encourage the imposition of some sort of barriers against importation in a foreign country, the argument could more easily be made out that the foreign industry is competing against a subsidized industry. You cannot be too definite about this, but there is an area here that bears thinking about.

MR. STEWART: I would like now to come

back to Section 83A and to some of the specific points that you have raised in this submission about that section. I turn to page III-7 of your brief. In subparagraph (a) of paragraph 20 you make the point, as I see it, that the taxpayers referred to there must bring into income now for tax purposes the proceeds of disposition of properties notwithstanding that they have not in fact been permitted to deduct the cost of those properties in the computation of income. Is that the substance of the point?

MR. McGREGOR: That is one of the points, yes, in subsection (a).

MR. STEWART: Then, may I put this to you, that at the present time there are no doubt properties of a very considerable value held in western Canada -- we are talking about petroleum properties, of course -- the acquisition cost of which is not deductable? You would agree with that?

MR. McGREGOR: Yes.

MR. STEWART: Now, if we provide that if those properties were disposed of the acquisition cost would be deducted, which it seems to me is what you are suggesting in subparagraph (a) here, would we not be likely to have a great many sales of petroleum properties, or even swaps of petroleum properties, so that the taxpayers could maximize their Section 83A recovery?

MR. MORRISON: Mr. Stewart, the only thing

I could say to this is that a straight swap would be the device used, and that we should look very carefully at Section 138(1) of the Act which says:

"Where the Treasury Board has decided that one of the main purposes for a transaction or transactions effected before or after the coming into force of this Act was improper avoidance or reduction of taxes that might otherwise have become payable under this Act...the Treasury Board may give directions as it considers appropriate to counteract the avoidance or reduction."

THE CHAIRMAN: You know that that section has not been relied upon, and I do not think that you are suggesting that it should be relied upon.

MR. MORRISON: No, I realize that.

MR. STEWART: You realize that there is a problem in what I suggest to you?

MR. MORRISON: Oh, yes.

MR. STEWART: I put it to you and while I have no idea of what was in the mind of the draftsman of subsection 5(b), I assume that this might well have been in his mind.

MR. MORRISON: Yes.

MR. STEWART: In subparagraph (b) on page III-8 you suggest, I think, that when one disposes of a petroleum property now the proceeds of sale should be treated as production income and not

simply as ordinary income.

MR. MORRISON: That is right.

THE CHAIRMAN: Now, I have heard this suggestion before, and I am still not clear as to the rationale of it. Depletion, as I understand it, is an allowance based upon production.

MR. MORRISON: That is right.

MR. STEWART: If a person holds a petroleum property and does not take production from it, but sells it, what is the reasoning which suggests that he should be entitled to a production loss on the proceeds of sale?

MR. McGREGOR: Only from the point of view that if he is in a taxable position he would only be allowed a deduction at the 33-1/3% rate, and if he turned around the following day and disposed of it he is taxed at a rate in excess of that.

MR. STEWART: Well, let us forget for the moment about the fact that there are properties around, the cost of acquisition of which is not deductible. Let us take a hypothetical company such as we did this morning, and let us suppose it is 15 years down the stretch so that it is in an income position, and that it spends $1 million on a particular property. It receives a deduction in respect of the acquisition cost, and if it is in a taxable position your point is that its effective rate of deduction may be -- the applicable

-19

rate may be 33-1/3%?

Mr. McGREGOR: Yes.

MR. STEWART: Suppose they hold the properties for a year and do not in fact take production from it so they sell the property then and bring the proceeds into income, then your point is that as this is not production income it will not have the advantage of the 33 1/3 per cent rate.

MR. McGREGOR: That is correct.

MR. MORRISON: In this connection, Mr. Stewart, the purchaser -- the depletion allowance rate to the purchaser reduced by one-third of the purchase price so when you look at the history of the total production, the depletion allowance would be reduced by one-third of the personal consideration involved in the transaction. This particular suggestion is made in the light of the net depletion. Gross depletion would be a different problem.

MR. STEWART: Yes. Well, I wonder if there is a problem here. I see the force of your suggestion. I am wondering if there is a problem arising from the fact that some taxes when they dispose of these properties are not taxable at all and will not be taxable because of the accumulated expense to carry it forward. Some will be taxed as 33 1/3 and some will be taxed at 50 or 52 per cent. Can you work out a general rule that does justice to all under the circumstances and by all, sitting here, I must include the revenue department.

MR. MORRISON: I would think what is suggested here would be equitable as long as we continue on the net depletion. If a company has a carry forward and sells a property there is not much

-2

of a problem involved on this particular question because that company can deduct drilling and exploration costs from that sale. This is a company whose principle business qualifies on the principle business classification. He can deduct exploration and drilling costs from the proceeds of that sale and then the result does not have too much or reduces the amount of exploration charge against the other depletable income. In other words, he is in a comprable position to the individual company in that respect but the individual who has one property is in an entirely different position.

MR. STEWART: Oh yes.

MR. MORRISON: So if that happened to be a depletable income in the hands of the seller and he applies the drilling and exploration expenses to it, it really doesn't change its eventual position or the eventual amount of the allowance but it does give the seller, as an individual -- does not reduce the amount between the individual and the company.

MR. STEWART: I think you have put this point somewhat different from anyone else who has appeared before us before and it can be considered on this revised basis by our staff.

THE CHAIRMAN: Do not leave that point, please, Mr. Stewart.

MR. STEWART: All right, Mr. Chairman, you go ahead.

THE CHAIRMAN: I am rather concerned with the general principle that one allows depreciation

which is a cost to the whole tax system and to every taxpayer and it is a cost for good consideration. The consideration is to encourage drilling. It seems to me one is allowing it in this case for reasons which have not got anything to do with encouraging drilling. It is pointed out because properties would be deducted at 33 1/3 per cent they should only be taxed at the same amount. I do not think I see that. They should be taxed at the lower level providing the taxpayer does what is thought to be in the national interest, that is developed and produced. If he doesn't do that, I would let him pay the full tax at the moment, unless you can persuade me differently.

MR. STEWART: Suppose, the argument that these gentlemen are putting is this, he has no alternative when he requires and the maximum deduction you can get is 33 1/3 per cent if he is in a tax paying position.

THE CHAIRMAN: Yes, I quite see that. It may be unfair to be taxed on the smaller amount if he gets taxed on the other side. I am not at all sure that is not our scheme of things. We permit the lower rate for a purpose and it must be for a purpose.

MR. MORRISON: We must consider there are circumstances. It is very possible that a taxpayer would be selling parts of his property to raise additional capital for a development. Perhaps he has a choice under some conditions of holding on to his property and borrowing money from the bank.

THE CHAIRMAN: On the other hand, he could

be a speculator.

MR. MORRISON: Yes.

THE CHAIRMAN: If he is, he ought to pay the tax the same as any other speculator, should he not, whether it is oil land or anything else. I don't think this is an easy one.

MR. MORRISON: Well now, moving on to paragraph C on this same page you refer to the fact that certain types of transaction cannot now be carried out except on a fair market value basis. Now, of course, I take it, what has happened here is that for the first time so far as the ordinary petroleum company is concerned the proceeds of disposition of petroleum properties have been brought into income. This means that when transactions are carried out on a non-arms length basis the ordinary provisions of Section 17 of the Act come into operation. Is what you are suggesting in effect this: That the normal provisions of Section 17 should not apply to transactions in petroleum properties.

MR. MORRISON: That are not at arms length.

MR. STEWART: Section 17 is the section that deals only with non-arms length transactions. What is there about petroleum properties which makes them any different than any other type of properties? Why should a property be treated differently for taxable purposes when it is involved in a non-arms length transaction merely because it is a petroleum property.

MR. McGREGOR: As distinct from what other type?

MR. STEWART: Industrial, factory or have it what you will.

MR. MORRISON: What we are suggesting really corresponds to what has happened in a factory. Section 24 applies to a factory and the original cost carries through from one term to the other.

MR. STEWART: You mean subsection 4 of section 20.

MR. MORRISON: Yes.

MR. STEWART: That is because it is a depreciable asset.

MR. MORRISON: That is right.

MR. STEWART: The provisions of Section 17 are a lot broader than that. Perhaps my example of a factory was a poor one. Let us take a transaction between a parent and a subsidiary in the petroleum industry on the one hand and in the baking industry on the other. Why should petroleum assets be any different from the baking industry assets or any other industry's assets.

MR. McGREGOR: Effectively we are just asking for the same treatment. In other words, if you have a bakery, you can transfer that by a non-arms transaction without attracting a tax. We are effectively saying we should have the same treatment.

MR. STEWART: Well now, we are now dealing with petroleum properties which I suppose are interests of a trader in land.

MR. MORRISON: We are looking at these as fixed assets.

MR. STEWART: I am wondering whether Mr. McGregor is referring me to the rules which relate to depreciable assets.

MR. McGREGOR: Well, along the same lines, Mr. Stewart.

MR. STEWART: There are lots of assets which are subject to Section 17 which are not depreciable assets at all, including land.

MR. McGREGOR: What do you have in mind specifically?

MR. STEWART: Let us take land. I suppose that Section 17 would apply there only if the taxpayer concerned was a trader in land.

MR. McGREGOR: Yes.

MR. STEWART: What you are saying in effect is that we are being treated as traders in petroleum properties.

MR. McGREGOR: That is correct.

MR. MORRISON: The whole point is that one of the things being taxed is the present worth of all future productions. This is putting into a current transaction a considerable fixed asset.

MR. STEWART: Are we not in the position that you people -- when I say you people I mean the industry as a whole -- has been anxious to get this deductible feature with regard to land acquisition costs. Now, can you have it both ways? Can you have acquisition costs deductible and not bring the proceeds into income.

MR. McGREGOR: If it is a non-arms length,

I think it would be very simple, Mr. Stewart. Nobody is looking for any tax advantage. All we are looking for is efficiency really.

MR. MORRISON: I don't believe we are asking for a deduction on the personal side of a non-arms length transaction.

MR. McGREGOR: We have it automatically.

MR. STEWART: If you amended 5(b) in relation to non-arms length transactions, I take it you would also have to amend 5(e).

MR. McGREGOR: Yes, or have the party enter into some form of agreement that neither 5(a) or 5(e) would apply to this type of transaction.

MR. MORRISON: Mr. Stewart, my feeling on this is that we have a Section in the Act referring to Successive Corporations which more or less covers the problem with provisions allowing deduction of income from a property and deductions carried forward to income from the same property and it seems to me that these sections are particularly related to this particular type of problem and they are the one that should remain in effect. 5(a) should be excluded from a similar type of transaction.

MR. STEWART: I understand correctly what you have just said you are suggesting in the petroleum industry so as to facilitate mergers and consultations, et cetera the law should be changed to permit people who are dealing not at arms length to move properties about on the basis that the purchaser does not get any deductions in respect of its acquisition costs

and the vendor does not have to bring the proceeds into income.

MR. MORRISON: Within the provisions that are already in the Act which allows successive corporations to deduct costs which would cover with the properties.

MR. STEWART: Are you now referring to 8(a) and 8(d)?

MR. MORRISON: Yes.

MR. STEWART: I follow you. Then in paragraph (d) of page 3.9 you refer to the fact that these taxes who in the 1962 amendments were given certain due treatment as regards to petroleum income, cannot deduct their exploration and drilling expenses from the proceeds of a sale of their property. You regard this as an anolamous situation.

MR. McGREGOR: Yes, that is true.

MR. STEWART: Is this something which up until now at any rate would primarily affect non-residents of Canada as regard Canadian operations.

MR. McGREGOR: You mean prior to the change in regulation?

MR. STEWART: No, I am referring you now to 4(b) and 4(c) type of individual.

MR. McGREGOR: Yes.

MR. STEWART: Let us take a foreign individual who is now permitted to deduct his exploration and drilling expenses but must also now bring into income the proceeds of petroleum properties. Is it the foreigner that we are thinking

of here in particular.

MR.McGREGOR: I think it is either the Canadian or foreign.

MR. STEWART: Would there be many non-resident individuals who would be affected by this?

MR. McGREGOR: I don't know. I haven't run across any yet. There seems to be a technical difficulty in the Act. It could be.

MR. STEWART: We have had this point raised with us before but I must say it does seem to me to be anomaly in the legislation. Well then, also on page 9 you suggest that the right to deduct exploration and drilling expenses from all incomes should in effect be extended to all taxpayers.

MR. McGREGOR: Yes sir.

MR. STEWART: Is it considered that if this change were made investment by individuals and by corporations which are not entitled to do this at the moment, invest and advise such people in the petroleum industry would substantially increase?

MR. McGREGOR: I think it is very difficult to gauge this, Mr. Stewart. Certainly they are discouraged at the present time. What the change would do, I would hesitate to guess.

In the petroleum industry, are these people inclined to take the same risks that the professionals in the business are likely to take?

MR. HAY: I think most of the money or interest raised in this area would be by companies and individuals who are considering associating themselves with people now in the industry, experienced operators. I would be surprised if this would result in individuals starting out on their own could drill a well. I do not think this would encourage individuals to spend their money on a business they knew nothing about. I do think it would open the door for individuals and people to become associated with concerns now in the business, and particularly the smaller concerns. There again, I come to the point of the small operator who needs to draw on sources of money which are not always available to him.

MR. STEWART: In other words, they would be partnership or syndicate arrangements?

MR. HAY: I think so.

MR. STEWART: If there were partnership or syndicate arrangements, would that be covered by the present sub section four?

MR. MORRISON: No, because the present subsection limits the deduction to the amount of income from production. If he purchased proven properties there would be nothing to stop him coming under 4(c). So it is risk capital we are speaking of.

THE CHAIRMAN: I am not unduly appalled

at the idea of being able to make deductions of 50 per cent when the benefits are only taxed at 33-1/3 per cent, although that does not seem to be very reasonable. But would it not open the door for what one might call "taxmanship"? I must say I have not thought of a way yet to take advantage of it, but I would expect our tax experts to be very busy figuring out ways to get deductions at the high rate and that the benefit at the low rate, and perhaps by guaranteeing a manufacturer had suffered by his expenditures and this kind of thing, or something like that. I would have thought that would be a rather difficult one to keep straight. It seems to me when you allow disparity between the production and the income, people are going to struggle very hard to find a way to seek rather abnormal advantages. Would you not think so, Mr. McGregor.

MR. McGREGOR: I suppose your point is that if we had somebody whose principal business was not the oil business but who had other outside interests, then presumably they would be getting a tax deduction for that investment in the industry at a five per cent rate. Really they would not be taking a low rate.

THE CHAIRMAN: If they are successful.

MR. McGREGOR: And if their property were disposed of it would be taxed at the same rate.

THE CHAIRMAN: If they were successful, I presume they would get the benefit of the low

rate of tax, would they not? And therefore there would be quite a difference between the deductions in respect of the costs and the tax on the benefits.

MR. McGREGOR: If they were successful operators, then they would only be getting an advantage at the low rate.

THE CHAIRMAN: That is right.

MR. McGREGOR: Because they would have to apply those costs against the production income.

THE CHAIRMAN: I was thinking more of manufacturers going into syndicates with oil people from time to time where their syndicate costs would be charged off against the manufacturing operations. If the syndicates were successful, I think the proceeds of the syndicates would come into them after having suffered a tax loss of 33-1/3 per cent.

MR. McGREGOR: Similarily initially their deduction would be 50 per cent until they were successful. After they were successful, then the deduction would be 33-1/3.

THE CHAIRMAN: Yes, that is correct.

MR. MORRISON: Our position is that we have to encourage people to take the risks in this industry.

THE CHAIRMAN: Yes, I am very suspicious of a situation where you get a bigger deduction when you are successful because I think everyone is going to work very hard to find a way to not lose and the only one who is going to be out in the

final analysis is going to be the government. It will require a little more thought than time will allow right now.

MR. STEWART: I noted on page IV-4 of your submission you indicate that you have found difficulties with the term which appears in sub-section 5(a) and which is set out at the top of that page. What is the difficulty with that definition?

MR. MORRISON: On the technical interpretation we feel there can be some question that the deduction would be allowed when hydrogen sulphide is present in the reservoir, to give an illustration.

MR. STEWART: In other words, how broad the words "...petroleum, natural gas or other related hydrocarbon (except coal)" will be interpreted is not yet clear.

MR. MORRISON: Hydrogen sulphide is not hydrocarbon; it is a raw material of sulphur.

MR. STEWART: Can you explain to us some of these other words in sub-section 5(a) following the ones that you set out here, and I quote:

> "....under which agreements, contracts or arrangements there was not acquired any other right to, over or in respect of the land in respect of which such rights, licence or privilege was so acquired except the right to enter upon, use and occupy so much of the land as may be necessary for the purpose of exploiting such rights,

licence or privilege..."

Do you know what rights over land can be acquired while still remaining within this definition?

MR. MORRISON: No.

MR. STEWART: Does this present a practical problem at all?

MR. PILON: I think the rights to which they refer there are merely the rights to work, which would be incidental to the use of the land for striking the petroleum.

MR. STEWART: Suppose with the right that is referred to here you acquire some surface rights or some depreciable assets, are you within the section or not?

MR. PILON: I think you are not.

MR. MORRISON: This is our concern -- that we are not. If we acquired the production equipment with the lease or bought the surface rights with the lease, the entire consideration would be not allowable and not just the amount of the cost of the surface rights or the cost of the depreciable assets.

MR. STEWART: Then I take it that if you have a sub-section 5(a) type of property and dispose of it, you bring the proceeds into income under 5(b), but you have to do this under the provisions of the 5(b) only if the acquisition was under the 5(a) type of agreement.

What I would like to get your comments on is this. A clear understanding of what is

involved in 5(a) appears to be important not only for the purposes of determining whether or not you have the deduction under 5(a) but the purpose of determining whether you have to bring the proceeds of disposition in under 5(b).

MR. McGREGOR: That would be correct.

MR. STEWART: I take it up until now at any rate the interpretation which the Department places on 5(a) is not clear?

MR. McGREGOR: There seems to be some ambiguity there.

MR. STEWART: I wonder if you could tell us -- and I am speaking now again about the 1962 amendments -- whether these amendments have had any material effect on property prices in western Canada? I see that on page I-3 you deal with paragraph 9 of this general subject and you do say in the second last sentence in that paragraph:

> "So far there has been no definite indication that these amendments have resulted in increased prices".

MR. HAY: Yes.

MR. STEWART: Would it be logical that, as tax concessions are made to your particular industry, one effect might be to increase the price which the industry was prepared to pay for properties?

MR. HAY: Yes, except that Canadian companies are competing against the price paid by companies coming under the United States tax situation, and so we consider that we are more able to compete

with the standard of values as it is established by them.

MR. STEWART: I think you would say the tax rate for American companies is even more favourable than the tax rate for Canadian companies?

MR. HAY: Yes, I think it is.

MR. STEWART: So if we in this country were to go to this depletion and thereby attempt to equate tax treatment with that of the United States, would this result in increases in Canadian prices, or do you consider that Canadian property prices are really pretty definitely linked with the prices of corresponding properties in the United States?

MR. HAY: I am rather inclined to think so.

MR. STEWART: That is, that they are linked?

MR. HAY: No, that they are set by the United States. To the extent that they are linked, we try to compete for properties against that price.

MR. SMITH: There might be another point here. I would say perhaps reasonably it might be expected as a short-run effect that property prices would rise immediately, but if the additional incentive that is being given is required in order to maintain an adequate level of industry development which in effect also means preserve an adequate rate of return, then the increased transfer from the treasury, if you like, cannot simply be turned over to the provincial treasury. It is a valid incentive which the industry requires to preserve that adequate

rate of return. But I think inevitably the impact effect would be reflected in the land, and would wear off, I think, in time.

MR. STEWART: And I notice that you say on page III-8 that the tax factor is a major factor in take-overs by the large integrated companies.

MR. McGREGOR: That is correct.

MR. STEWART: Now I would like to come back to depletion. I think you mentioned in your submission, and I think you may have mentioned this verbally today as well, that depletion has been taken in Canada to date by your industry only to the extent of about $150 millions.

MR. McGREGOR: That is our best estimate, yes.

MR. STEWART: How would you arrive at that figure?

MR. McGREGOR: We made a survey of the industry -- rather, the Association members -- to which we received replies from over 70 per cent of the industry by gross revenue. It is based on those figures.

MR. STEWART: I would like to ask you this. Is the fact that there has been this relatively limited amount of depletion taken essentially a reflection of the fact that the industry in Canada is in an early stage of development? If again we refer to this study of yours, by way of illustration, there is no depletion taken by an independent, a non-integrated company until it gets to its 18th year.

If an independent company in Canada had been formed in 1947 and had had a reasonable degree of success, it would still not be in its 18th year, so is it not likely that many of the taxpayers, many of the companies in the industry have been formed much more recently than that and are in an early stage, and as the industry matures the returns on depletion will considerably increase?

MR. McGREGOR: I would say generally we are approaching Year 18 within the next three or four years, for the majority of the industries.

MR. STEWART: What are the proven reserves of the industry at the present time?

MR. MORRISON: Proven are 4,400 million barrels, not including the probables.

MR. STEWART: These are proven, 4,400 million barrels?

MR. MORRISON: Yes, that is the proven only.

MR. STEWART: What about the probables?

MR. SMITH: I think we have given those figures in the brief. They are given on an ultimate probable basis.

MR. STEWART: What page is that?

MR. SMITH: I do not think it is in the form you require. I was looking at section II-28. It does not give the cumulative position. It gives it annually.

MR. HOWELLS: What does the figure represent? It is the main reserves and not the ultimate proven.

MR. SMITH: Yes, it is the proven, and the question relates to the probable. I do not know.

MR. HOWELLS: In speaking of reserves I will say that we follow the A.P.I. system which eliminates the probables. We have enough difficulty in the business without getting into classifications.

MR. STEWART: Very well, let us deal with the proven. At the end of 1962 there were 4,400 million barrels of proven reserves.

MR. MORRISON: That is crude oil.

MR. STEWART: Yes, crude oil only. As that oil is produced production income will presumably be quite substantial, and subject to what develops

so far as further exploration and development is concerned the present depletion allowance also produces very substantial amounts?

MR. McGREGOR: Depending upon the amount of exploration there is.

MR. STEWART: Yes.

THE CHAIRMAN: Are you going to ask what the gas reserves are, Mr. Stewart?

MR. STEWART: Yes. I am not sure whether those appear in this submission or not.

MR. SMITH: No, but again on a proved basis, and converting to a comparable proved basis, there would be a further roughly 1,779 million in natural gas -- that is in crude equivalent -- and then a further again 695 million in N.G.L.'s -- or natural gas liquids -- which would suggest the total proved reserves of some 6,950 million.

THE CHAIRMAN: And we can multiply that by $2.40?

MR. SMITH: Yes.

THE CHAIRMAN: That does not come very close to a rough figure that I got by an entirely different method. I may be very much mistaken, but I took the production for 1962, which I think is the last year given and I found that the total revenue was a little over $1 billion. In petroleum it was domestic $635 million, and export $243 million; domestic gas $91 million and export $72 million. I added them together and I came up with $1 billion. Then I said that, well, there are 19 years of crude

oil, or natural gas -- I cannot remember which, but I think it was crude oil -- and 30 years of natural gas, so we have got somewhere between 19 and 30, and I multiplied between 19 and 30 by $1 billion, and I got myself a figure of something over $20 billion. What is the difference between that and about $15 billion or $16 billion?

MR. SMITH: It is $16.8 billion, I guess.

THE CHAIRMAN: $16.8 billion, is it?

MR. SMITH: Yes.

THE CHAIRMAN: What is the matter with my getting at it in that way. I think I am conservative, because the market is increasing.

COMMISSIONER WALLS: Were you not working it out at $2.45, whereas gas is less than $2.45.

THE CHAIRMAN: No, he has worked the equivalent out. I was not using anything. I was using the figures in the brief.

MR. SMITH: The natural gas liquids introduce some variation here. I am not too knowledgable of the current price, but I think it is customary to work with a price of about $1.95 or something like that. You would multiply the natural gas liquids reserves of 695 million barrels by $1.95 rather than $2.40. This would reduce the total value of the reserves somewhat, but I cannot say by how much.

THE CHAIRMAN: It does not matter. I took $1 billion and multiplied it by the number of years to go. It may be an exaggerated figure, and probably

is. You have 17 billion here. Now, do I understand that this, whatever it is -- oil, gas or natural gas liquids -- is available by simply turning a valve, or do you have to use pressure to get it off?

MR. HAY: There has to be more expense.

THE CHAIRMAN: You have to spend something to get that out of the ground. It does not come out by just turning a valve?

MR. HAY: Yes, and the oil and gas has to be transported to the terminals.

MR. STEWART: Now, gentlemen, I would like to go back to your specific proposal about depletion. I think the American system is described on page 2 of your case study here where you say that depletion is computed on a property by property basis based on a percentage of gross income, 27½ per cent, and limited to 50 per cent of net income without deducting unsuccessful off-property drilling and exploration costs. Then you say, alternatively, that cost depletion must be claimed if it is more favourable than gross depletion. Now, your proposal is a straight 25 per cent gross rate, as I understand it with no limitation as to net income at all, and without any qualification about cost depletion. Are the rules you are suggesting not more favourable to the taxpayer than the American rules?

MR. McGREGOR: I think in practice, Mr. Stewart, the 50 per cent limitation does not have too great an effect on properties until you get very much down the road.

MR. STEWART: I guess this is the point which either you or Mr. Morrison made a few minutes ago, that you thought the effect of the 50 per cent net income limitation was to reduce 27½ per cent to 23 per cent or 24 per cent?

MR. McGREGOR: Yes.

MR. STEWART: Then, I would like to ask this question: In your brief at pages II-29 to II-31 you refer to the tar sands, and to their potential importance, and my first question is the obvious one, I think: Why should we be concerned in Canada about continued exploration for conventional crude when we have the tar sands there with no exploration required.

MR. HAY: Here again I think we have to keep in mind the time periods involved. I pointed out in my opening remarks that there is much work to be done in order to bring the tar sands into commercial production, and that work is being done and has been underway for a good many years already, and a good deal of money has been expended in finding out a profit.

Any person who has said he is ready to develop the tar sands has put in some rather rigid qualifications as to when he will do that, and we believe that there still remains a good deal of time and a good deal of effort needed to show that the commercial operation of the tar sands is economical in relation to the conventional crude. We think the time is so far ahead that we can think in terms of perhaps ten years before production from the tar

sands becomes a factor in the need for crude oil in Canada.

There is the possibility of starting up some plants before that time, but the plants have to be developed step by step in order to make sure that we do not burden ourselves with a great oomplex of industry that is less efficient than is needed by bringing the tar sands into operation progressively. I do not think that it is in the minds of any of the people involved with the tar sands that they will ever do more than be able to supplement the natural crude. It is true that these reserves are there, but winning them to the extent of doing away with the conventional crude is not the concept of those who are interested in them in the foreseeable future.

COMMISSIONER WALLS: Did you not state that you have already estimated that the drilling costs, or the production costs, were the equivalent now of well drilled oil elsewhere. I presume that that was done on the basis of one and ten that you developed when you worked that cost, but I understood you to say earlier in the hearing that it was on the basis of equivalent costs of production.

MR. HAY: I do not think I have mentioned that. However, to speak on that point, I think there have been presentations made to the Conservation Board to the effect, subject to continued results and favourable results of that research, and a satisfactory quantity, that there are people who believe that oil from the oil sands could be produced competitively with

today's prices for crude oil at Edmonton.

THE CHAIRMAN: Has anybody produced satisfactory commercial crude oil in the smallest quantity from the tar sands?

MR. HAY: There has been crude oil produced in the order of a pilot plant stage from the oil sands, but this still requires, and it is still undergoing, significant work and research to bring that to the point where it could be a commercial product in a pipe line which is useable, and commercially feasible.

THE CHAIRMAN: I understand.

MR. HAY: Bringing the oil sands into commercial production does not involve a single break-through of a secret for winning the bitumen on the sand. It requires a number of correlated procedures and experiments, and this ---

THE CHAIRMAN: Accepting all that, and accepting that it takes a long time from the pilot plant to the commercial operation, we have enough oil developed for 19 years, so I am told here; will we not have the oil from the tar sands running out of our ears within 19 years?

MR. HAY: Following through what we say here in this forecast, we say while at today's consumption we have enough oil for 19 years we also say that by 1970, when we consider the increase in demand for oil, we will only have enough at that time for 13 years, and that is not enough to see us through until such time as the oil sands are

useable.

THE CHAIRMAN: Has anybody estimated how much more we need to make the two match?

MR. HAY: Nobody has said that.

THE CHAIRMAN: There have been some speculations on it, I suspect.

MR. HAY: If somebody will say that -- yes, I think there could be some work done on it. I am saying this on the basis of what has been presented to the Alberta Government as to how fast the oil from the tar sands could be brought into production step by step, and this could be co-related with what should be done on conventional crude, so that at the end of 1970 we would have enough oil in the ground to assure us of bridging that gap.

THE CHAIRMAN: I find it hard to understand why we should be digging holes a mile deep when we have the stuff lying on the surface.

MR. HAY: I do too, but my best answer to that is that the industry that is spending its money as it is, and that has been paying rentals on that, continues to look for conventional crude. The industry as an industry is not convinced that the oil sands are going to replace conventional crude, otherwise there would be nobody drilling for oil. They would all be sitting back and producing for 19 years, taking advantage of the tax situation and making a lot of profit. The industry is not doing that.

COMMISSIONER WALLS: Not even when you have nine holes out of ten that are dry, which has

DD-9

been the recent experience?

MR. HAY: That is right. I am not sure whether it is relevant or not, but the industry believes that when it is looking for conventional oil it is more than half way through the woods. It knows that it is going to get a good well through, and this is the thing that keeps us going.

COMMISSIONER GRANT: In connection with the oil sands, Mr. Hay, is it true that recently some of the companies have withdrawn and have given up their leases because of the expense which is involved, and which they did not wish to face? Did I read something to that effect within the last month or so?

MR. HAY: Yes, I think that some of the companies that have carried on expensive research work have reduced the intensity with which they have been carrying on the research, but they have not abandoned it.

COMMISSIONER GRANT: Have not Canadian Pacific abandoned their rights?

MR. HAY: They did not exercise certain options they had to become participants in the project, but nevertheless that project is continuing as a project and it has a commitment to build under certain arrangements with the government.

MR. MORRISON: Before we leave this subject, sir, I wonder if the term 19 years production ratio is fully understood? Is there any doubt or is there any feeling that because we have a 19 year supply ratio this well can be produced in 19 years. This is not the case.

THE CHAIRMAN: It may only last 13.

MR. MORRISON: Some may be produced for 40 years. When you get down to 12 or the 13 year supply of ratio, as I understand it, that is the minimum ratio to meet peak demands during different seasons. If you get down to the five or six supply of ratio you would not be able to produce that in five years. You would not be able to meet the demand and still take another 10 or 14 or 20 years to produce that.

THE CHAIRMAN: I did not fully understand that. Is that because the pressures fall off and you cannot get it up?

MR. HAY: When we say we have a 12 year's reserve, we mean we have enough crude reserve in the ground to supply the demand at that time for 12 years but that does not mean to say in terms of conservation that we can pull that out of the ground in 12 years. It may take 40 years.

COMMISSIONER GRANT: I was just going to ask a question of Mr. Hay to the last three or four years. Has exploration been successful in bringing in proven reserves an amount which would exceed the yearly increase in consumption and if so, by how much?

MR. HAY: I think there is an answer to that.

MR. SMITH: The figures that are shown in Section 2 of page 28 refer to something called "Ultimate Reserve". In developing these figures an attempt was made to take the proven reserves and add to those from available information an estimate of what would subsequently be added as a result of further developments drilling and the figures for the last three years then are not what has actually been added but something more than this, representing this estimated amount as I say, that may ultimately be added.

We just noticed these figures. They run 10 million barrels, 116, 254 and the production rate in crude oil only during these past three years has been rising but has been 191, 221 and 244. So that without also adding in the N.G.L. and the natural gas equipment, which are in these reserve figures, we can see that the rate of addition has been below the rate of production. I think that is your question.

COMMISSIONER GRANT: Yes.

MR. SMITH: I would say that on a proper basis or a proven basis are substantially higher -- though not so in 1962, where they were more closely in line.

COMMISSIONER GRANT: So you actually are drawing on proven reserves to meet our daily requirements.

MR. SMITH: Well, I am sorry. We have to be careful about these.

MR. HOWELL: The point I had in mind is headed by the column and refers to reserves credited back to the discovery year. In other words we might this year discover a new field and the reserve determined during this year, let us say, take a figure of 15 million barrels and in subsequent years we will expand that field by added drilling plus the fact that we will increase the reserve costs by 50 per cent by secondary recovery methods so that the actual figures for the year is not the correct one to go by.

MR. SMITH: No. This is right. There is another figure here which adds up to the total addition to reserves in a given year, which in the last three years, has been substantially higher than the withdrawals from the reserves and this is because of the additions through development drilling and revisions to earlier discovery.

THE CHAIRMAN: As I read this last night I had great hopes that at last we were going to see reasonable amounts by the time we had gone another five years, which I would expect. You explain you get it by dividing them up?

MR. SMITH: I think you can see that the rate of the finding these last three years, the finding of new reserves has not matched production. This is not quite the same thing as saying the reserves are not still rising more rapidly. They are because there will be additions to earlier finds.

COMMISSIONER WALLS: In your Chart No. 1 you deal with imports and exports and you exports are up very close now to your imports. I presume that means that we import predominantly from the Eastern United States whereas you export from the West to the United States? Is that the reason for this, Mr. McGregor, that it is easier to bring in oil to the Easter Seaboard than it is to ship our own Canadian oil to those areas?

MR. HAY: Yes. The flow of crude oil generally is Tidewater oil reaches Montreal and the Maritimes and the Canadian oil reaches Toronto and Canada West and from there also into United States and Sarnia or across Puget Sound.

COMMISSIONER WALLS: Our exports of oil are mostly to the United States but our imports, I presume, are from Venezuela?

MR. HAY: Venezuela and the Middle East into Eastern Canada. We supply by export the Puget Sound area and the Minneapolis and St. Paul area and the Toledo-Buffalo area -- not all their requirements.

COMMISSIONER WALLS: I So I suppose those two mean we shall never really attempt to be self supporting and we shall be both an importer and exporter?

MR. HAY: Well, let me say it the other way around. As long as it is cheaper to bring crude into Montreal that is to pipeline it from Western Canada it appears that is the way it will be handled.

THE CHAIRMAN: We will be self sufficient

in the next year or year after.

MR. SMITH: On balance it would be pretty close. At the present time for 1964 we have produced 870,000 barrels and our consumption is around 950,000 to one million so we are approaching the balance in the course of the next few years.

THE CHAIRMAN: I noticed that your statement of receipts and dispursements in the industry was very interesting. You were down $1,800,000,000 in 1947 up to now.

MR. HAY: One billion.

THE CHAIRMAN: One billion?

MR. HAY: Yes.

THE CHAIRMAN: You have got considerable for that $16 billion in the ground.

MR. HAY: Yes.

THE CHAIRMAN: Is that roughly the economics of it? It seems to me it is or am I missing something? I think in that $1,800,000,000 you did not take into consideration the taxes paid.

MR. McGREGOR: That is right.

THE CHAIRMAN: Or the interest on the money?

MR. McGREGOR: That is right.

THE CHAIRMAN: That is unfair. You should have taken those in. If you had you would have a larger figure.

MR. HAY: Yes, we would have a larger figure. I think there might be some adjustment to make in the $2.40. In addition to the pumping costs

there are royalties and some other costs before we consider that money in our pockets. Of course, we might emphasize the fact that although we say it has 19 years some fields could be producing for 40 years so we are not going to do it in 19 years.

THE CHAIRMAN: At first sight it looked as though the Canadian Industry was a pretty bad industry but it seems not too bad if after $2 billion we have a national asset worth many times that.

MR. HAY: The asset is there. It is the cash to keep running, to keep us in that position which seems to be our problem.

COMMISSIONER PERRY: If we can talk about your arithmetic projections for the future it is quite obvious from the calculations on page 232 and the preceding pages that everything hinges on your per barrel cost of finding oil.

MR. HAY: Yes.

COMMISSIONER PERRY: And you have taken the figure of 67 cents and given the reasons for taking this. I agree this is a matter of judgment and probably you are much better qualified than I am to do that. I am wondering if you wouldn't agree this is probably putting things in the most dismal possible light because if you go back to the total on page 28 I think you would have to agree that the characteristic of the pattern is irregular particularly in the third column and that if one were even to take the last six years rather than the last five years, 67 cents would probably go down considerably because

1957 was quite a high year on finding. In other words you are really assuming that there are not going to be any more big years.

MR. SMITH: I don't know that. It does not seems unreasonable to me to conclude that there is something of a trend in Chart 3 data shown opposite page 28. It is obviously characterised by wide variations but I think moving over the bases and just a visual inspection leads to some conclusion that in fact it is becoming more and more difficult to find oil, which is really the trend we are talking about.

COMMISSIONER PERRY: My visual inspection is that up to 16 years there are five of them that were over 500 in the last column.

MR. SMITH: It is getting tougher.

COMMISSIONER PERRY: There are 13 of these 16 years that are over 100. The last three years, I would think, just looking at the column quite exceptional years.

MR. SMITH: Apart from this statistical aspect which you interpret one way ---

COMMISSIONER PERRY: No, I am sorry. This is the way you have interpreted it.

MR. SMITH: My interpretation is that there is a decline in trend, which was my interpretation of these figures. That is all I am saying. Your interpretation evidently is to go more to the irregularity. Apart from the statistical interpretation I think our interpretation is supported by the technical fact, if you like, that the lines are obvious. More

EE-8

difficult, more subtle, more obscure pools lie ahead. This does not remove the possibility there would not be any other major finds. I don't mean that. Obviously, our readily exploitable resources have been done first, so to speak. I think the trend has varied in this sense. This is a rather typical re-sort development trend, I would say.

COMMISSIONER PERRY: Are you still not saying that none of these subtlely hidden resources which would be difficult to find won't be a very spectacular find.

MR. SMITH: In our projection ---

COMMISSIONER PERRY: You are sort of saying nothing exciting is ever going to happen in this business again.

MR. SMITH: We are probably saying that on a probability basis, the most reasonable assumption for forecasting the period we have been concerned with is that we will not do better and therefore we assume 67 cents constant cost in the forecast period. And I would think that is a fair assumption, and a defencible one, not the most dismal. Surely we can extrapolate this trend ---

COMMISSIONER PERRY: The point is that you do not have to bring the costs down to the previous level of 20 cents to get any dramatic change in your result.

MR. SMITH: Quite so.

COMMISSIONER PERRY: All you have to do is bring it down to 60 or 55 cents.

E-9

MR. SMITH: That is quite true but all it has to do is go up to 70 or 71 -- so this is the kind of situation we are in.

COMMISSIONER PERRY: I hope you are at a ceiling at 67.

MR. HAY: Mr. Perry, we are looking for oil in more difficult areas where we have to drill deeper wells to see what is there. We have to spend more expenses on exploration before we drill a well.

COMMISSIONER PERRY: I am not challenging the increasing difficulty at all. What has disturbed me more is this increasing difficulty seems to be an increasingly frustrating process. The more difficult it is, the less likely you are to find it. I do not see that you can say that in your most difficult and expensive year of all in the future you would not discover another Leduc.

MR. SMITH: This is one reason they persist in this.

COMMISSIONER PERRY: Yes. I must say I have a large question mark opposite 67 cents, even so.

MR. SMITH: Is it not the important thing that this is not unreasonable surely in any forecast and planning projects such as this you have to make reasonable assumptions and this is the way it can be a factor and still concede that many factors could change the event.

COMMISSIONER PERRY: I am willing to accept this represents your best judgment in the matter.

However, going forward on this calculation to page 34, paragraph 94, you say, "The final step of the analysis" -- this is the last sentence in the paragraph --

> "there remains now the matter of the industry's ability to attract funds either from internal or external forces for these investment purposes."

Then on page 35 you work out your calculations comparing funds generated with the outlays, and you come to the result that without any external funds at all your revenues will exceed your outlays. Does this imply that in a period of very substantial growth for this industry you would not be justified in having some new external money in the industry?

MR. SMITH: Well, we go on to 98. Then there is another point which is brought out -- the variation in individual firms experience within the broad aggregate.

COMMISSIONER PERRY: On the problem of averaging, but you would have to agree on the basis of your own arithmetic that you are thinking entirely in terms of internally generated funds.

MR. SMITH: That there will be enough funds generated, leaving, however, $1.85 billion investment to be covered, plus more if tax and interest are reduced.

THE CHAIRMAN: That $1.85 billion is pretty well secure, I would have thought.

MR. MORRISON: I think you should remember here that this only pretends to be a comparison of amounts of money; I do not think there was any suggestion here that it should be entirely financed internally. Some companies have debts to be repaid and some shareholders demand return on their money in the meantime, so we have to get additional money in here through reborrowing or in some other way to finance this. This is not supposed to indicate a financing structure in any way.

MR. PERRY: No, but the main significance is that it is the basis on which you are supporting your evidence here.

The argument appears to be that enough funds should be made available to the industry to meet this expenditure in the period to 1970, and I am suggesting that the objective is achieved without any use of external funds.

MR. MORRISON: I think this indicates there is not even a reasonable return on the present investment.

COMMISSIONER PERRY: Well, a return may be in your 15 or 20 year reserve with which you end up at the end of the period. You are assuming you have paid for all this at the end of the period.

MR. SMITH: It is a question really of how long must the pay-out period be. If the two were equal by chance, if the investment requirements were equal to the sums generated, this would surely suggest that the pay-off is beyond 1970. This would suggest

that some pay-outs would be realized, depending on the industry distribution versus investment requirement.

COMMISSIONER PERRY: There is another factor. A good deal of the oil that you are using up will not be 67 cents oil.

MR. SMITH: That is quite true.

COMMISSIONER PERRY: We do not want to get this too complicated.

MR. SMITH: That merely says if we do not go on at 67 cents there will be quite a bit of revenue coming in.

COMMISSIONER PERRY: Just what interpretation do you put on the last sentence in the footnote of the table at 14. It says that the unrecovered expenditure includes royalties and taxes other than income taxes. Does this mean all royalties including current production royalties or just land acquisition royalties? I am asking to be instructed on this; I am not sure which it should be.

MR. SMITH: Would you say that again, please?

COMMISSIONER PERRY: I am asking whether it includes all royalties, including your 12½ or 15 per cent over-riding royalty as you produce, or whether it is just land acquisition, leasehold bonuses or whatever you want to call them.

MR. SMITH: No, it is not; it is included just as gross income on a gross barrel basis prior to the payment of the per barrel royalty.

COMMISSIONER PERRY: On the top of page 37

you make the tantilizing statement that while you are producing non-integrated oil companies have not had a return on equity or debt and equity up to and including 1958. Is there any data available as to the position since then?

MR. McGREGOR: I do not have it. I do not know whether we have it. I assume we have something.

COMMISSIONER PERRY: Is this just the year in which your data runs out or is this a turning point year?

MR. McGREGOR: That is a turning point year.

COMMISSIONER PERRY: So you think it may have gone over to the other side following that?

MR. McGREGOR: It is possible.

THE CHAIRMAN: And to the extent these are development companies, the success is not just measured by the problem of the cost and the dividends, but also by the development of the reserves. Without stating whether or not reserves have gone up or down we do not know the full story, do we?

MR. McGREGOR: That is correct.

COMMISSIONER PERRY: Then on page III-10 I am just wondering whether I missed something later in the brief which seemed to be promised in paragraph 24 which speaks of the deductions that individuals and corporations can take in the United States for drilling and exploration expenses from all brackets subject to certain limitations referred to later herein. I looked for these limitations because I was

particularly interested in what they were in the case of an individual, and I did not find a further word on this subject. It may be there and I may have missed it. It is something of which we hear a great deal but of which as yet you have not spoken.

MR. McGREGOR: On page III-17, Mr. Perry, the reference previously is really to the comparison on this page here where the United States operator captalizes certain land acquisitions costs and geological costs for which the Canadian operator gets an immediate deduction.

COMMISSIONER PERRY: I see. That is not quite what I thought was involved in this. I was reading that as referring to a private individual making a contribution towards drilling and prospecting in the United States. It is not that that you have in mind?

MR. McGREGOR: No, it is just these limitations here and the deductibility of expenses.

COMMISSIONER PERRY: This is one other point on the American treatment. You are quite well aware, I am sure, that the depletion allowance in the States in a sense is partly recovered through the capital gains tax because it serves to reduce the basis of the property against which it is allowed. A royalty holder or anyone holding an economic interest, in their terms, in production receives depletion allowance but on the sale of that economic interest he would have to reduce the base of the property for capital gains tax by the depletion allowance received.

So where there is a sale and realization, in a sense the depletion is recaptured through the capital gains tax.

I have never understood the full implication of this, particularly as to how it might apply to the shareholder of a producing company that has qualified for depletion allowance, whether this affects the base of his shares for capital gains tax. Would anyone in this group be able to throw any light on this? I think it is a very essential piece of argument because you must pursue most of these things right through to the end to get their full implication .

MR. McGREGOR: My understanding would be -- and I may be corrected -- that the shareholder of the American producing company does not have his cost basis for his stock reduced by any depletion allowance.

COMMISSIONER PERRY: It is not reduced?

MR. McGREGOR: No.

COMMISSIONER PERRY: So it would have to be someone holding a royalty interest that would suffer a reduction in the value of their interest?

I am fairly clear on this. I have an official publication in front of me which makes that part fairly clear. I have never seen it quite spelled out so positively as to whether this had any implications on shareholders. I think I would agree with you that it probably has not.

MR. McGREGOR: I do not believe it does.

COMMISSIONER PERRY: No.

COMMISSIONER GRANT: I have one or two

questions.

You refer to technological developments and what those developments are going to mean to industry both by way of reducing exploration costs and improving reserves. You also, I think, somewhere in the brief refer to advances which are now being made and which have been made recently in scientific processes and in discovering oil, and I think the brief refers to that in the geological sense.

MR. HAY: Yes.

COMMISSIONER GRANT: Is there anything expected there that will reduce the costs materially if it does come through?

MR. HOWELLS: If I may speak to that, Mr. Hay, it is rather difficult to assess the ultimate limits of research. You must work for a long period of time and come up with negative results. However, I cannot remember the exact paragraph here but I think there was reference to the decline of geophysics as a tool today because most of the obvious structures and reefs and other such things where we find oil are quite readily detected relatively close to the surface by seismic methods, but when they reach depths of several thousand feet or more, then they are obscured somewhat and there is an element of doubt whether you do or do not have a reef there. When we get away from these obvious reservoirs, as we call them, we are going now for pinch-outs in sedimentary sections or pinch-outs in porosity, and these cannot be detected by seismic or other geophysical measures, so we must

do sub-~~surface~~ research in examination of rocks, the horizontal variations and so on, and come up with some other method of determining or at least roughly delineating some area we would consider prospective. The ultimate aim would be to drill a well there with the hope that you would find something. This is a very expensive method of doing it. There are other types of research.

We hear of the chemistry of soils and their applications sometimes questioned very seriously by some scientists and accepted by others, but this is all a process, a conglomeration of research that goes on in all larger companies with the hope that we will ultimately find some refinements. We believe we have made some real approaches to our ultimate aims, but when they will be pay-offs there it is just like any other research, it is rather difficult to determine.

MR. HAY: Perhaps in the same category as the item you were mentioning is the advances the industry has made in recovering more and more of the oil in the ground. This has been done by maintaining pressure and by various methods of secondary coverage.

COMMISSIONER GRANT: And at the present time the Faber field.

MR. HAY: It is going on in the Faber field today, and research and experience is contributing a great deal to our knowledge of how to do this in various circumstances. This has contributed a great deal to the reserves we are now publishing as proven reserves as against what we have found by wildcatting.

We are running out of named fields now and that is why we have to do more wildcatting.

COMMISSIONER GRANT: I have one more question and I may be foolhardy to put it to you, but here it is.

Under the laws of the United States they charge their casings as capital expenditure whereas in Canada you are allowed to charge it as an expense. This I should think must result in an exploration and producing company being able to write off a very large amount, higher, of course, than it would be if this expense was capitalized in its early years. If it were preferred you would be in a position to take advantage of your depletion allowance more quickly.

Would you like to comment on what effect that might have on the industry?

MR. McGREGOR: I do not think it would be too serious from the point of view of the Canadian industry, Mr. Grant. If it was a capitalized expense in Canada, such as the capital costs allowances, the rate would be 30 per cent on a reducing balance, which is the rate applicable to all our oil well equipment; therefore, in the first two years alone you have 51 per cent of that item back.

COMMISSIONER GRANT: I was thinking more particularly of United States rate, if that were possible to apply on a straight line?

MR. McGREGOR: That was a composite rate taken from United States. The casing costs amounted to only 15 per cent of our total drilling costs; that

FF-10

was our estimate. So I do not think it would be a very serious thing either way.

THE CHAIRMAN: Thank you very much indeed. You have been very patient with us. We have run out of questions now.

This has been a most helpful day. As you know, we are not experts in the oil business but I think as I predicted earlier, we know more about it than we did when we started. Certainly we have a very healthy regard for the two recommendations which you make in your submission, and which are matters of considerable importance and we will give careful consideration to them. They are of considerable importance quite obviously to you and, quite obviously to taxation.

All I have to say is thank you very much indeed for all you have done for us today and the preparation of this very excellent job that I have before me and all the work that has gone into it. It is nice to have seen you, gentlemen; thank you.

MR. HAY: Thank you very much, Mr. Chairman.

THE CHAIRMAN: The hearing will stand over until 9:30 tomorrow morning.

--- Adjournment at 4:50 p.m.

ROYAL COMMISSION

ON

TAXATION

HEARINGS

HELD AT

OTTA

ONT.

VOLUME No.: 97

DATE:

OFFICIAL REPORTERS
ANGUS, STONEHOUSE & CO. LTD.
BOARD OF TRADE BLDG.
11 ADELAIDE ST. W.
TORONTO

364-5865 364-7383

ANGUS, STONEHOUSE & CO. LTD.
TORONTO, ONTARIO

ROYAL COMMISSION ON TAXATION

Proceedings of hearings held before the Royal Commission on Taxation in the Supreme Court of Canada Building, Ottawa, Ontario, commencing at 9:30 a.m. on Thursday, January 23rd, 1964.

COMMISSION

MR. KENNETH LeM. CARTER — CHAIRMAN

MR. J. HARVEY PERRY

MR. A. EMILE BEAUVAIS

MR. DONALD G. GRANT

MRS. S. M. MILNE

MR. CHARLES E. S. WALLS

LEGAL ADVISER

MR. J. L. STEWART, Q.C.

RESEARCH DIRECTOR

PROF. D. G. HARTLE

SECRETARY

MR. G. L. BENNETT

* * * * *

INDEX TO EXHIBITS

NO	DESCRIPTION	PAGE
288	Continuation of: "Brief, Canadian Institute of Chartered Accountants".	9125
340	Brief of Royal Architectural Institute of Canada.	9054
341	Submission by the Financial Executives Institute of Canada.	9063
342	Supplementary Brief, Investment Dealers' Associationof Canada.	9125
343	Supplementary Brief, Equitable Income Tax Foundation.	9125
344	Brief from Mr. R.S. Ball, Winnipeg.	9174

* * * * *

SUBMISSION OF ROYAL ARCHITECTURAL
INSTITUTE OF CANADA

THE CHAIRMAN: Mr. Secretary?

MR. SECRETARY: Mr. Chairman and Commissioners, this morning the first submission is being presented by the Royal Architectural Institute of Canada. There are two gentlemen present to speak to the brief, Mr. J.W. Strutt, Honorary Treasurer, and Mr. M.J. Holdham, Executive Secretary of the Institute.

Mr. Chairman, I would like to enter this submission into the record as Exhibit 340.

EXHIBIT NO. 340: Brief of Royal Architectural Institute of Canada.

THE CHAIRMAN: Good morning, gentlemen. You have put in the briefest brief so far. It is a brief which is very much to the point and easy to understand. You recommend that the income tax law be amended to permit registered architects to average their income over more than one year, and you speak only with regard to architects because it is architects you represent. However, you have no objection if your recommendation is extended to others, I presume.

Is there anything you would like to say to us in regard to your submission?

MR. STRUTT: Yes, Mr. Chairman, I am pleased that our short brief appears to be effective in a sense, but we would like to say that, as you are probably well aware, architects cannot incorporate

and are therefore taxed yearly as individuals. They obtain their commissions in a way which is not controlled. The commissions are not controlled by the architects and the architects are unable to stabilize their operations. The duration of each commission may vary from several months to years, and much overlapping results from this unavoidable practice to which architects are subject.

It is well known that some projects extend over as long a period as five years. You will appreciate that under these circumstances architects' earnings are subject to extreme annual fluctuations. They may pay a disproportionately heavy tax one year and a low tax in other years. They are thus placed in an adverse position.

As an example, over three years an architect may earn $5,000 and $5,000 in the first two years and then $50,000 when he has worked over a period of years and received the first remuneration for the work done. His total tax over those three years would approximate about $21,310. If he was allowed to average it over, say, a period of three years his tax would then be $16,000, a saving of $5,000.

Within this context, a more specific consideration in our recommendation might be that it be averaged over a period of three years, and that from its inception should be retroactive.

THE CHAIRMAN: Thank you very much indeed, Mr. Strutt.

Your organization is made up of roughly how many architects? How many are in practice and how many are employed?

MR. STRUTT: That is very difficult to answer. I would say about 1,800 are in practice.

THE CHAIRMAN: And quite a number employed I imagine. Would there be as many employed?

MR. STRUTT: No, not quite.

COMMISSIONER PERRY: Your total figure is 2,500, so the balance would be employed.

MR. STRUTT: Yes. It would be probably about half and half.

COMMISSIONER MILNE: You do mention, Mr. Strutt, that the variations can be extreme, and certainly in the example that you cited the variation was extreme. Would there be many that would be as great as that?

MR. STRUTT: I would say probably not as great as that. I used an extreme example. However, in a sense it is not that extreme in that this happens continually and that very few practising architects are in a position to be able to manage their commissions in such a way that they come to any average at all. Variation is the rule rather than any sort of norm.

COMMISSIONER MILNE: For instance, in your second year -- in which you suggested it was another $5,000, similar to the first year -- would you not have any anticipation in that year that

the very large fee would come in the third year?

MR. STRUTT: Yes, that is true, you would have.

Perhaps I can give a more specific example of a commission where it literally took that length of time to do the work and for his first fee to be paid on that commission. He may be doing other work at the same time, but it is conceivable, and has happened many times, that this spread of time has existed. His charges exist continually -- that is, payment to his employees and so on to carry out the work. This really occurs twice in a big commission where his first payment is at completion of sketches acceptable by the client and the second is when the working drawings and tender documents are ready for tender. This may take even longer than the first period. So this discrepancy in time is extreme, within the context of your question.

COMMISSIONER GRANT: Will you just carry that a little further, Mr. Strutt. So far, his fee is paid in two instalments.

MR. STRUTT: Yes.

COMMISSIONER GRANT: It is the custom of the profession that the balance of the fee be paid at the conclusion of the contract or in progress payments.

MR. STRUTT: In progress payments on the invoices tendered by the contractor as the work proceeds. Construction may take a period of two years.

There may be monthly requests for payment from the contractor. The architect's final payment of fees is distributed over these monthly periods, so that the three breakdown characteristics of this fee payment are such that the last one is spread out over the construction period.

COMMISSIONER GRANT: But as he certifies a progress payment to the contractor, his own fee is included?

MR. STRUTT: That is correct. He would apply for his fee.

COMMISSIONER GRANT: He receives a cheque on account of his fee at the same time as the contractor receives a payment?

MR. STRUTT: This is correct. This proportion, I might add, is a percentage or a very small proportion of a quarter of his fee or a third of his fee as the case may be. In other words, if we break down his total fee into three parts, the third part is for supervision, for which he receives increments.

COMMISSIONER GRANT: Would he receive a third fee before work commences on the contract?

MR. STRUTT: No, he would receive a third fee when that part of his work is completed.

COMMISSIONER GRANT: His drawings and specifications are completed at the time tenders are called?

MR. STRUTT: Yes. This is the second

stage.

COMMISSIONER GRANT: But the combined first and second stage takes up a third of his fee, does it?

MR. STRUTT: Two-thirds.

COMMISSIONER GRANT: They are broken down into thirds?

MR. STRUTT: Yes.

COMMISSIONER GRANT: Preliminary sketches --

MR. STRUTT: Yes, and tender documents and supervision.

COMMISSIONER GRANT: But preliminary sketches and consultations constitute one-third?

MR. STRUTT: Yes, this is the first one-third.

COMMISSIONER GRANT: The completion of the plans and specifications in a form in which tenders are called for is the second stage?

MR. STRUTT: That is right, that is the second stage.

COMMISSIONER GRANT: So by the time the contract is let he has earned two-thirds of his fee, has he?

MR. STRUTT: That is correct.

COMMISSIONER GRANT: The remaining one-third is paid in instalment payments as the contract progresses.

MR. STRUTT: That is correct.

COMMISSIONER GRANT: And he is paid the

balance of his fee at the conclusion of the contract when the building has been turned over?

MR. STRUTT: Correct.

COMMISSIONER GRANT: Has this staggering of payments the effect of easing the tax burden on the architect, in so far as the point to which you are addressing yourself in your brief?

MR. STRUTT: I do not think it was ever calculated to do this in the first instance, It was with regard to his service to the client and the reasonable cut-off points, let us say, of his particular work, and the nature of the work in the design of a building. I doubt very much that it was ever related to tax considerations.

COMMISSIONER GRANT: But certainly he does not receive his whole fee.Say,for instance, the tender is for $1,000,000 and his fee is 6%.

MR. STRUTT: Correct.

COMMISSIONER GRANT: He does not receive $60,000 in one lump sum.

COMMISSIONER PERRY: In practice he does or does not.

MR. STRUTT: He does not.

THE CHAIRMAN: We were pondering whether architects were in the habit of accruing their fees or taking them up just when the cash is received. I think the latter is the case.

MR. STRUTT: Yes, it is.

COMMISSIONER PERRY: Do you have any limitation in mind reflecting the degree of change between one year and another or do you have in mind that this will be open to all concerned even though there will be only a minor change?

MR. STRUTT: I do not understand the question, I am sorry.

COMMISSIONER PERRY: It is quite a specific question. Some people have suggested averaging with the limitation that it only be available at, say, one year at 10% higher than the previous year. The difficulty is an administrative one. If it is available to all taxpayers, they might

have people averaging who were simply going through their normal earning process with one year being slightly higher than the previous year.

MR. STRUTT: No, I think our concern is applicable only to the explanation that I previously gave, and that is at times our personal income becomes so disproportionate to previous years, in any one particular year.

COMMISSIONER PERRY: You have no concept of the disproportion in mind?

MR. STRUTT: No.

I am sorry, I think I see the point you are making. I would think a 10% fluctuation.

COMMISSIONER PERRY: A 10% fluctuation would take care of most of it?

MR. STRUTT: I would think so, yes.

THE CHAIRMAN: I think I understand what you have put before us, and thank you very much for doing so. I might say that you are not the first to recommend some kind of averaging, because there are others in similar circumstances. As you know, there are averaging provisions in the law now but they are for specific forms of occupation, and several people have suggested that they should be made more general. Whether that is feasible I honestly do not know, but I assure you that we will consider it when we come to prepare our report on the matters that are before us.

Thank you very much for coming here today and for your assistance.

SUBMISSION OF FINANCIAL EXECUTIVES INSTITUTE OF CANADA

THE SECRETARY: Mr. Chairman, the second submission this morning is being presented by the Financial Executives Institute of Canada. Mr. N.J. Brown, who is the President of the Institute and Vice-President and Controller of the Steel Company of Canada, is here together with a number of his associates. Mr. Brown will make a few introductory remarks and will introduce his colleagues.

I would like to enter this submission into the record as Exhibit 341.

EXHIBIT NO. 341: Submission by the Financial Executives Institute of Canada.

THE CHAIRMAN: Good morning, Mr. Brown. We have read your submission with a good deal of interest and we will probably have a few questions to put to you, but before we do so perhaps you would care to make some introductory remarks.

MR. BROWN: Mr. Chairman, Commissioners, we are here this morning to present our brief brief. But before presenting it I would like to introduce our representatives here. Starting on my right, this is Mr. Allan Greenman, Manager of the Financial Department of Shell Oil of Canada. Next, Mr. J.A. Ross, Vice-President and Treasurer of Shell Oil of Canada; next, Mr. Kenneth Place, President of Du Pont of Canada Limited; then we have Mr. R.E. Karr, Assistant Controller of the Steel Company of Canada.

I think perhaps it will take the least amount of time if I paraphrase from the introduction of our brief.

The Financial Executives Institute of Canada is pleased to have an opportunity to submit a memorandum to a Commission to set up to examine the operation of Canadian tax laws.

The Institute, which is the Canadian division of Financial Executives Institute, formerly the Controllers Institute of America, is a management organization whose main purpose is to provide a means for the exchange of ideas and the development of improved practices and policies in financial management.

This Institute has a membership of approximately 300 senior accounting and financial accounting officers of the larger and medium-sized companies in Canada. We feel in our respective positions we have a great deal to do with the administration of taxes. For example, the responsibility for tax administration in the Steel Company of Canada is one of my functions, and likewise in the case of Mr. Ross and Mr. Place in their respective companies.

When we undertook the preparation of the brief we felt that other groups, in which were represented many of our members, would deal with economic and many other aspects of taxation. We thought we might do something more useful if we confined our brief to the administrative problems, dealing

with the tax laws, the interpretation of the laws and the application in daily business transactions. Therefore, as you will note, we have not attempted to get into the philosophical or economic discussions with regard to tax. This was not altogether because we wanted to confine ourselves merely to tax administration but partly because we did not feel particularly qualified to deal with other aspects.

Frankly, after doing a great deal of reading of some of the briefs that have been presented and many other articles that have appeared, I am a little confused by the complexity of the economic problems, and I am rather pleased that we are going to confine ourselves to this one area.

You will have noted, of course, that of the subjects with which we do deal, first and foremost in importance is this at times vexing problem of distribution of corporate income. We have some suggestions to make on how that might be handled. We have suggested the imposition of withholding tax of 15%. We deal also with the disallowances under Section 12(1)(a) and (b). We come out on consolidated returns, business losses. We have something to say about incentives, the matter of penalty interest on assessments. We have a few remarks to make on sales tax, the co-ordination of tax policy, provincial and federal, and this suggestion about public discussion prior to budget changes so that we may be able to

anticipate to some degree the repercussions of the actions of government.

THE CHAIRMAN: Thank you, indeed, Mr. Brown. I think it is good you stated those matters with which you have almost daily experience; but let me assure you that if we draw you into economics, well, we are all to some extent perplexed, and I turn to Mr. Perry.

COMMISSIONER PERRY: "Particularly Mr. Perry" !

THE CHAIRMAN: I think it is almost fair game, for anybody who gets into economics. This is an area where one cannot ignore it: where one is talking about taxation one must be concerned about the effects of taxation. But I agree with you, there is a large administrative area with which we can primarily concern ourselves today, rather than the economic effect in tax changes. This is the Canadian position of the Financial Executives Institute. We have already had a submission from the Toronto Branch, I think, or the Montreal Branch of your organization -- am I not right?

MR. BROWN: I do not think so, not to our knowledge.

THE CHAIRMAN: Not to your knowledge?

MR. BROWN: No.

THE CHAIRMAN: I was curious, should I have been correct you were together in your submissions, but if I am not correct ---

COMMISSIONER PERRY: You might be confusing it with the Tax Executives Institute that we have heard in Toronto.

THE CHAIRMAN: That may well be. On page 3 you refer to the matter of double taxation and distributions to shareholders, and the desirability of avoiding a further tax; and you go on to recommend, I believe, that the dividend tax credit be gradually increased.

Before we get to that, there are two things I think are generally responsible for the dividend tax credit -- mainly, what you referred to as "double taxation", and also the liability of Canadians investing in Canadian stocks, and an increase in that would presumably assist towards that end. But is there double taxation? And if so, to what extent is there? Nearly everybody coming before us speaks of this matter; but recently -- in fact, this week -- we have had two groups who have indicated very clearly to us that if there was a reduction in corporation tax it would be passed on immediately in lower prices, but the shareholders would get no benefits to it. That causes us to wonder if it were in the reverse direction whether likewise an increase would be passed on to the customers rather than the shareholders. If so, is all the corporation tax being borne by somebody other than the shareholders? If it is, I would not have thought there was any double taxation.

MR. ROSS: Our main purpose in putting in this proposal was purely the practical question of simplification of the Act. We did not intend to get into the question of double taxation. I think it is perfectly true that if the corporate tax were reduced

or eliminated there would be a lowering in prices, and presumably the converse would happen otherwise. But we are in a free market economy, generally speaking, and there are market prices which form a limitation on your ability to recover costs.

It is very clear in many industries -- and I guess they are all in industries where this is a problem of life.

THE CHAIRMAN: I dragged you right into economics in the first question, but in the middle of the page I have underlined "double taxation", and that is in quotation marks, and as you say you are leaving it in quotation marks. You say that if a case as to that had been made you are suggesting administrative means of avoiding it, if there was in fact double taxation.

At the bottom of the page -- unless anybody has anything before we come to the bottom of that page, page 3?

COMMISSIONER PERRY: I was impressed with the opening statement of paragraph 5, in which you say:

> "In our opinion, the area within the taxation most urgently in need of attention is that dealing with the distribution of corporate earnings."

This, again, is in the focus of this whole brief, and not in the general, broad sense of weight of taxation on business, but in terms of things in your focus. This is the thing that ought to be done quickly.

This is No. 1.

MR. ROSS: This is one of the chief time-consuming areas of the Act.

MR. BROWN: It seems to us the simplification of this part of the Act would greatly reduce the amount of time spent in dealing with this situation. We thought that is where the main simplification might arise.

COMMISSIONER PERRY: It is a matter of getting on your wave length. Most executives who come here have talked about the rate of corporate tax.

MR. BROWN: We all have our problems and opinions too. Everybody is out to reduce taxes -- except, perhaps those collecting them. I feel that a reduction in corporate tax is to be desired, if we could also have a reduction in government expenditures. However, when it becomes a matter of allocation of taxation as between corporations and other groups, that is a far more difficult problem, trying to determine who bears the tax. These are the questions you are undoubtedly trying to answer.

MR. ROSS: From our point of view it does not really matter whether the tax rate is one of 35 per cent or 50 per cent ---

COMMISSIONER PERRY: Or ten per cent either. Why do you say this has a restrictive effect on the freedom and flexibility of corporate organizations? In other words, if you surplus provisions and other provisions you cannot rearrange

your structure in an efficient way. There are all sorts of corporate set-ups which look like a nightmare and could be changed very drastically. Do you feel your full efficiency of operation is impeded?

MR. BROWN: We are thinking of artificial complexities introduced -- if you want to put it loosely, ways of getting around some of these regulations. I cannot think of any situation in our own company which would greatly or substantially impair the efficiency of operations of the manufacturing concern.

COMMISSIONER PERRY: You can get around it someway or another.

MR. BROWN: It is complex, time-consuming and costly.

MR. ROSS: I think there is a premium on being sophisticated. People who could afford good legal counsel could do it,

THE CHAIRMAN: Mr. Perry and I recently had a conference in France, and Europeans indicated that,sophisticated as they might be, taxation prohibited the bringing together of economic entitites or the consolidating of two or more companies. The English speaking countries I think all said they were able reasonably well to achieve what they are now talking about, pointing out, of course, there were complexities. But it seemed to me there was a distinctive difference between the European countries -- excluding the U.K. -- and the rest of us with regard to that, and I think you would agree that very

seldom is trade blocked on account of taxation.

MR. BROWN: It might be seriously delayed. I can think of situations where because of the tax laws of Canada we have had to spend months trying to find a method of setting up the organization. This is not to evade tax, but it is hard to arrange the kind of corporate organizations necessary to carry out a major project under the circumstances that Canadian laws do not provide for. There is nothing in our law to provide for joint venture. This may be getting off the point, but it is an example of the complexities that arise, and we might spend months trying to establish a modus operandi for this venture. To some extent this might be considered as inefficient, because if there were an easier way to do it and a more efficient way of getting to the main purpose of organization we might be in production of ore that much sooner.

THE CHAIRMAN: You can attribute an actual delay in production of ore to tax laws?

MR. BROWN: Yes.

MR. KARR: In order to arrange your affairs so you do not pay tax unnecessarily; I think that is true.

MR. GREENMAN: Specifically on a designated surplus, if you have a corporation in your family whose surpluses are designated, if you do what comes naturally, a reorganization or simplification of your structure might cost you the full 52 per cent. If you get busy and plan other types of consolidation your

tax costs might go down to 20 per cent. On the other hand, if you are really smart it might cost you nothing. But in the background is a lot of doubt as to whether it should cost anything merely to re-arrange your corporate affairs; and yet a designated surplus operates in such a way you ~~run~~ into deemed distributions, even though there was no dividend stripping intent originally, and the reorganization has no sinister implications whatever for the revenue.

COMMISSIONER PERRY: It is probably always going to be the case it will be in the taxpayers' interest to be sophisticated, but I would agree we are in a situation where the taxpayer who is not sophisticated has just "had it", and this is not good enough.

MR. BROWN: Is not that an argument for trying to simplify the situation, if possible and feasible or with regard to some of these regulations so that people who are not quite as sophisticated and cannot afford the fees have a chance to benefit as well as the others?

MR. GREENMAN: I think, as people who administer these things, sometimes we get tired of being sophisticated.

COMMISSIONER PERRY: You like the simple life!

MR. GREENMAN: We do cost our corporations money, I suppose, sometimes for that reason. We might turn down a plan that seems too sophisticated, and

3-8

perhaps in the background is the threat that whatever we do might be deemed to be artificial and a sham. We might find ourselves in court, and this would not be pleasant for anyone.

MR. ROSS: I think the main thing in our minds is the blunt instrument intended to patch the minor number of people who want to profit by dividend stripping, and it catches most people, including those who have no such intent.

THE CHAIRMAN: I think it had a very real purpose at the time it was introduced. There were transactions going on where people were using the assets of a company to buy the company. That situation required some kind of law. It might not be the best law; but it was a law. Certainly, I hope none of you has ever paid the tax on surplus.

MR. ROSS: We have.

MR. GREENMAN: We are about to pay a small amount to get rid of a problem, but still at the rate of 52 per cent.

THE CHAIRMAN: I was going to come to the bottom of page 3, the endorsement of the concept of a flat 15 per cent tax on corporate distributions. Certainly a flat rate of 15 per cent would offer a simpler method of dealing with the distribution. The question is whether or not, of course, that would be fair. We are tied to a method of progressive taxation. Certainly that method could be changed, but just for sake of this discussion, supposing it is not changed, and supposing we have progressive

taxation on our salaries, other earnings, and so on, is it fair to come to a flat tax in respect of dividends which would clearly be a pretty substantial benefit to those people who have rates of over 35 per cent? It would certainly change our pattern of taxation on investment income. It is strongly represented to us that proportional taxation of income would be pretty unfair, and throughout the whole would result in regressive taxation. We need progressive income tax in order to balance the regression of other taxes. Of course, we have both sides of this argument; but that is one argument. I must say, at the moment I find it a little difficult to accept that one should go to a flat rate of the taxation on such income, as against a graduated rate of tax on other incomes. Would you let me have an argument on that.

MR. BROWN: That is a toughy. There are two schools of thought. One would eliminate tax on dividend income entirely, perhaps partly based on the argument it is double taxation, to which you have previously referred to; and secondly, because it does not represent such an important item in the collection of revenue -- an estimated $500 million. Therefore, we are trying here to weigh the advantages of eliminating or simplifying the legislation relating to the distribution of corporate income as against the revenue it raises.

When you come to the question of incidence, and whether it is fair, I presume you mean, fair to all taxpayers -- whether it is equitable for a person

who does not receive any income through dividends to pay on a progressive basis, and whether it is fair that a person who gets all his income from dividends is free. It does not seem fair, just instinctively, that a person whose entire income comes from dividends should pay no tax at all, whereas as somebody like myself who is paid a salary has it taken from him right at the start. I think it was for this reason -- and I am speaking for myself -- that it was felt there should be a tax on dividends. It is pretty hard to say what is the fair burden, how you allocate the burden of taxation. This is the 64 million billion dollar question. I felt there should be a tax on dividends. This can resolve in some criticism, and it will be critized because it is not the best, but I do not know.

THE CHAIRMAN: I think it certainly is a problem with which we will have to wrestle. At the moment I find it difficult to get this completely into focus.

MR. BROWN: Would it be feasible to find some way whereby these corporate distributions between corporations, where a company takes over, you could move the surplus to the company provided it has not distributed and then when it came to the ultimate distribution to the individual that the conditions as they exist remain. This would accomplish in part what we are attempting to do, to simplify the business administrative part of this problem.

COMMISSIONER PERRY: Theoretically this is a system now if it were not for designated surplus.

MR. BROWN: If we have solved designated surplus, perhaps part of this problem would be solved as well.

THE CHAIRMAN: One has always got to be concerned about the locking up and indefinite postponement of tax on surplus which is arranged in such a way as to never be distributed because the present value on future tax at a date which is unforeseeable and which is infinite, is nil.

MR. PLACE: In our view I think I am speaking for the rest of the members when I say that the present graduated rate of tax on income does inhibit distribution of dividend income. There are

many corporations that are fairly closely held and where the individual shareholder's decision has considerable impact on dividend policy. And with the high graduated tax on income, there is a tendency in many corporations to limit dividend payout. Because of that it is our feeling also that with the rate of taxation somewhere in the area of 15 per cent would perhaps encourage a higher payout of earnings on the part of a significant number of corporations.

THE CHAIRMAN: I think what you are saying is that under the present system the tax on distributed income is higher than the tax on undistributed income. There are two ways to cure that. There could be an adjustment to either distributed or undistributed. Put down the tax on distributed income or put up the tax on undistributed income if they are out of balance. You think they are out of balance.

MR. PLACE: My feeling is that the man whose income comes from investment, in fact, that income has already borne a heavy rate of corporate tax. If the residual balance which was then available for distribution was subject to the present income tax on the high graduated rate then, quite conceivably, he will end up paying a considerably higher over-all rate of taxation in the final analysis than simply the graduated rate.

COMMISSIONER PERRY: The question is whether people would be satisfied with that 15 per cent. Those who have been stripping surplus in the

past have not been satisfied with 15 per cent. They want zero per cent.

MR. PLACE: I don't think we are particularly interested in people who are simply attempting to strip dividends.

COMMISSIONER PERRY: I think this will leave you with a problem of retaining some sort of apparatus for preventing this.

MR. PLACE: We agree. We think there are other methods of doing that than a straight graduated tax rate on dividend income.

THE CHAIRMAN: You would be raising the taxes on dividends for all those people who now receive their dividends at a rate of less than 35 per cent, would you not?

MR. GREENMAN: There would be our optional procedure which we also recommend to take care of the status quo for this.

THE CHAIRMAN: Yes, you would permit an option.

MR. GREENMAN: This was in lieu of the Special Committee's Recommendation which had to do with an over-all income test, 10 per cent I believe and a withholding tax to be refunded. It did not seem to us to have sufficient provision and this led us to the optional procedure as the smoothest way to handle that feature.

THE CHAIRMAN: And then you would not have the withholding tax?

MR. GREENMAN: This would simply amount to a refund on the ordinary filing of an income tax return. I think we would still advocate the withholding procedure.

THE CHAIRMAN: For Canadian resident shareholders?

MR. GREENMAN: Yes.

COMMISSIONER GRANT: I think on this point from this submission that the way the option applied would be applied on the grossing up basis, would it not, Mr. Chairman?

THE CHAIRMAN: No, that is not what these people are putting before us.

COMMISSIONER GRANT: I think it was before us previously.

THE CHAIRMAN: That was another one.

COMMISSIONER GRANT: I am wondering if your reference to deductibility relative to carrying charges if you apply it to the option by inference? You do not exclude that from carrying charges where a dividend is deducted at the source, or do you?

MR. GREENMAN: I think we intended that when you speak of options that the existing rules remain in effect for any who chose to go that route where the 15 per cent withholding would certainly be on gross and without any consideration of carrying charges. So it would be an alternative way of calculating your tax. They could be on two entirely different bases.

COMMISSIONER GRANT: I was wondering

there as to the logic of excluding carrying charges from the withholding tax.

MR. GREENMAN: I don't think we paused long over that one. However, the withholding tax is surrounded by many philosophical considerations including the question of progressiveness and so on. It is a new deal. We thought the question of carrying charges, there would not be any point when we come to the optional procedure, it is just a matter of maintaining the status quo for those who would benefit by using it.

MR. KARR: I think what was intended here was basically the accept the Special Committee's Report as a starting point and give you on two or three instances where we feel there should be an option. The Special Committee's Report did call for a straight withholding tax without deduction for carrying charges. Our viewpoint on this whole thing is largely one of simplification.

COMMISSIONER GRANT: Thank you.

THE CHAIRMAN: Now, I want to take you into this question of inter-corporation dividend, 15 per cent. Whether that is the only way to do it, fairly, I don't know. You would apply, as you say, the Section 105(c) formula which would cause 15 per cent to be paid only when there is a disappearance of assets. I am not altogether clear just how that would work but presumably when two companies come together the resultant assets are less than they were before they came together, it would be deemed that there had

been distribution and to that extent the 15 per cent tax would be paid over. Is that what you are getting at?

MR. BROWN: Yes, broadly speaking.

MR. GREENMAN: This reference referred to some pretty heavy work the Institute had done in response to Mr. Fleming's request in the 1960 Budget Speech where he asked organizations like ourselves to work on the problem and put in a recommendation. We did put in a recommendation. It was backed up by a formula and schedules and I suppose it would take too long to go all over it now, but our submission is on the record somewhere and we did do a lot of arithmetical technical text work on this formula. I will just mention what the formula was. It involved a tax base which would be derived by substracting from the amount of the dividend the net assets of the receiving corporation. This is an adaptation of Section 105(c) following the same philosophy. One of our schedules attached to that submission actually showed the rationale of the adaptation.

MR. ROSS: That may have been the submission you were thinking of, Mr. Chairman. It was two or three years ago.

THE CHAIRMAN: It may be.

Do you know how 105(c) has worked out in practice? Has it bogged down in matters of valuation or generally speaking is it fairly satisfactory?

MR. GREENMAN: In our case the tests could be applied without adding any work at all because obviously companies like ours with heavy equity capital meet the test immediately but we don't know

how it has interferred with dividend stripping. Perhaps the question does not come up because dividend strippers can discard this method because they can see themselves they would have an argument over the text.

THE CHAIRMAN: I cannot say from my experience whether it has worked or not but certainly we will take a look at it and see whether this matter of disappearance of assets is something which can be measured.

MR. BROWN: I don't think we have had any experience at all in our own corporation.

COMMISSIONER BEAUVAIS: I have two questions to ask. On page five you suggest that the 15 per cent would not apply to the movement of surplus between a corporation. This might lead in some cases in avoiding the 15 per cent tax because if, as you suggest, the assets are transferred from one company to another, then the receiving corporation could fill these assets and in turn apply the receipts therefrom to pay a loan which had been contracted to acquire the shares of the subsidiary.

MR. GREENMAN: Yes. That is the purpose of the 105(c) test. Our argument is that if the 105(c) test fails to disclose that there was a disappearance of assets through the repayment of a loan, that is the traditional way assets will disappear -- true -- one company might have a loan on the books and yet there is such healthy equity capital obviously there will still be enough assets retained to cover

distribution to individual shareholders and provide a revenue basis for proper tax.

COMMISSIONER BEAUVAIS: In cases such as the one I just mentioned to you, you would consider that as a disappearance of assets.

THE CHAIRMAN: The assets would have gone out to buy the shares.

MR. GREENMAN: Yes. Our concern with dividend stripping here is whether there are enough assets left in the family to match the undistributed income particularly of the acquired corporation.

MR. BROWN: The principle is there should be assets there at all times to cover that undistributed income. If you can guarantee that, it seems to me we take care of the situation you mentioned.

COMMISSIONER BEAUVAIS: In cases like that, the assets have disappeared.

MR. BROWN: Yes, that is right.

COMMISSIONER BEAUVAIS: Another point you have mentioned is the Special Committee's Recommendation No. 6. I wonder if you have given any consideration to that recommendation.

MR. BROWN: I will take a look at it.

MR. KARR: This is a special incentive to provide for a lower rate as a starter. I don't think as a group we need consider that particularly because I think it gets us into the realm of the economic incentive generally needed. I think it is fair to say we have not formed any opinion on that particular

point.

COMMISSIONER GRANT: I would like to ask a question in connection with the third paragraph of page 5. You would permit payment of dividends provided that it did not go to the extent that it was endangering, what I think the law would call, the sub-strata of the company. Would you go that far?

MR. ROSS: I don't quite know what you mean, sir.

COMMISSIONER GRANT: You would allow an encroachment of assets by way of dividend payment -- I am wondering where you would stop or do I interpret this correctly?

MR. GREENMAN: We would stop again at 105(c) formula, as I said a few moments ago, compare the undistributed income of the family of companies with the assets that had remained behind in those two companies.

THE CHAIRMAN: I think in the simplest terms 105(c) means simply after a transaction there would be no less assets than there were before a transaction.

MR. BROWN: Yes, that is our recommendation.

MR. GREENMAN: Our adaptation is meant to cover the dividend after the situation rather than the amalgamation. This is taking a slightly different turn but it seems to arrive at basically the same point. We are interested in what a group of companies do after everything is taken off and that there are

enough assets to cover or match the amount of undistributed income that is still waiting for taxation on the ultimate distribution. Then it does not matter to the revenue whether we call the remaining assets capital or surplus because, of course, the procedure is that the first assets out go to satisfy undistributed income.

THE CHAIRMAN: You have developed a formula for this, you have told us. I do not think we have ever seen that formula. Is there any reason why we should not see it?

MR. GREENMAN: Not at all.

THE CHAIRMAN: Will you be so kind as to send it to us?

MR. BROWN: Yes.

THE CHAIRMAN: Thank you very much.

Paragraph 6 deals with the 12 (1)(a) and 12 (1)(b) expenditures and suggests a separate class of capital assets so as to pick up some of the things generally that have been referred to before us as "nothings". Is there anything you would like to say to that? We have had this matter put before us quite a few times.

MR. BROWN: The Chartered Accountants' brief has an appendix listing the classical examples. I do not know if we have any unique or new examples to add to that list, but we feel the same way as they do about this particular issue.

THE CHAIRMAN: Is there anything further on 6?

In your point 7 you suggest:

"....permitting taxpayers to elect to file consolidated returns for parent companies and 100 per cent-owned subsidiaries, resident in Canada, without any increase in the rate of tax."

To the best of my recollection this is almost the first time we have had this put before us. I do not think it is the first time, but it is just about the first. I have been surprised, and I think I was coming to the conclusion that perhaps there is not much need for consolidated returns. Are you conscious of any circumstances in which people have paid more tax than they would have paid if consolidated returns had been permitted? Has there been any harm which has come about from the fact that consolidated returns are not now permitted?

MR. KARR: The answer to the question as far as our own company is concerned is no, but there have been instances where it has meant an unusual amount of effort to straighten out an organization and prevent the loss of deduction for tax purposes.

THE CHAIRMAN: I think there is no doubt that people have had to arrange things to achieve consolidation, but I think those devices have now been accomplished for all time. That being so, is there any purpose in introducing this now?

MR. KARR: If there is nothing inequitable or unethical about putting together consolidated returns in contrast to a series of separate returns, and if by doing so you can avoid extra administrative work, it seems to us it would be logical to propose it.

COMMISSIONER PERRY: Have any of you had any experience with the English device of subvention payments between interrelated companies?

MR. KARR: Apparently this has to be preceded by a contractual arrangement for this purpose. It sounds quite simple and seems to eliminate all the problems of consolidation. You simply make a payment from one company to another and it becomes deductible to one and taxable to the other.

THE CHAIRMAN: And I think it has the advantage that you do not need to restrict it to those subsidiaries which are wholly owned.

MR. BROWN: We have not had any practical experience on that.

MR. ROSS: It gives you all the advantages of a consolidation, I take it.

COMMISSIONER PERRY: It seems to. As usual, these things break down a little bit on closer inspection. It sounds quite simple.

MR. KARR: It sounds much better than a consolidated return.

THE CHAIRMAN: You only go so far as those which are wholly owned and there may be a pretty strong case for others too, although it would be much more difficult to see how to do them on the basis of consolidation.

COMMISSIONER BEAUVAIS: If it is for tax purposes and the carry forward period is not permitted, would you still suggest consolidation?

MR. KARR: Yes, because there can be a situation where a particular company in your organization is in a loss position, there is no prospect of it coming out of that loss position, for a particular reason you want to maintain the existance of that company and your carry forward of the loss does not help you.

THE CHAIRMAN: You would remove any limit on the carry forward period? I see. But you think in order to dispose of matters probably you should limit the carry back period?

MR. BROWN: Yes.

THE CHAIRMAN: I wonder if there are not administrative reasons for restricting carry forward too, although I cannot for the moment think of any?

MR. BROWN: I was going to ask you if you could suggest any.

COMMISSIONER PERRY: It may be just a matter of how long the Taxation Division is able to store returns from past years. I suppose with large corporations they have them going right back to the beginning.

MR. BROWN: They have to, yes.

COMMISSIONER PERRY: I do not know whether this is generally true of all corporations.

MR. BROWN: I suppose there could be a practical reason for it not going back too far and perhaps the indefinite carry-forward might be subject to the same comment. In any case, I think

what we are advocating is some liberalization in the carry forward provisions.

MR. PLACE: I do not think that should present a tangible problem for Du Pont of Canada, and I am sure many of you are aware of the segregation that took place in our company in 1954. At that time we were required to trace our earned surplus right back to 1917. We had to do it. If it is required, one has to do it. There is no possibility of saying that the records are not available. It seems to me the same type of records should be available to support loss periods and carry over, and it seems to me the availability of records is not really a problem.

MR. BROWN: The onus is on the company and if they cannot produce the records they will be denied the opportunity.

THE CHAIRMAN: What do you think about the trading losses? Would your proposal increase the amount of trading losses, and if so is that in the national interest or against the national interest?

MR. PLACE: I am not quite sure.

MR. BROWN: Would you amplify?

THE CHAIRMAN: If you carry losses back further and losses forward further, they become more valuable. There is more incentive to put the company up for sale and more incentive for someone to buy it.

MR. KARR: I do not think the amount should have any bearing on it. If you want to intro-

duce something to prevent trading losses, you need that whether it is a dollar or a million dollars.

THE CHAIRMAN: The benefit is over five years. It is not quite as valuable if it is continued to no limit whatsoever. It would seem to me that a company which had a loss would be in a very much more valuable position when it ceased to operate than it is now.

MR. KARR: That is true, and it seems to me the main point is not to penalize the legitimate operator because there is something open to the illegitimate.

THE CHAIRMAN: You favour trading in losses or you think it is a bad thing?

MR. BROWN: What is the situation now, Mr. Chairman? Is there a lot of trading in these losses? If it is not serious, then the question would be of extending it, making it indefinite, and then would that change the situation?

THE CHAIRMAN: There is certainly some trading in it; I have seen it. And I have seen some advertisements in the papers. I suspect if we opened it indefinitely we would see more transactions and more advertisements in the paper.

The law does its best to combat it, believing it not to be in the general public interest. Now some people think it is a good thing.

MR. GREENMAN: We were under the impression that the state of the law as it stands now offers pretty good protection having to do with the shareholding test. If there are new

shareholders coming into the picture to control the company, then the loss and the profit must be in the same business. I have noticed that the Board and the courts are interpreting that more strictly these days, more strictly than they used to do. So even though it would appear to the layman to be the same business, nevertheless, if there is a cessation of business for a brief time and then a starting up again doing the same thing -- I am thinking of house construction which I believe was the latest example -- it seems in that case to the layman that it was the same business but the Board or court interpreted it the other way. So I would think if it is genuinely the same business, then there is no reason why the losses should not be applied to profits many years ahead.

THE CHAIRMAN: Your recommendation may not promote simplicity. If it makes this a bad thing, the law is going to try and shore that up and the law, when it does that, becomes more complex.

MR. ROSS: We have a later proposal here about establishing the amount of negative income, and that would assist the simplicity of determining carry forwards, I would think.

THE CHAIRMAN: Paragraph 8 deals with incentives:

"(a) Consideration should be given to a general liberalization of the present capital cost allowance rates available to all taxpayers on a continuing basis."

Before we move on to any other, let us consider how much more liberal that should be. It is a little hard, I think, to measure just how liberal that is at the present time. There is a measurement, and that is the extent of the reserves that one sees in a company's balance sheet, and the difference in the taxes would have been the best measurement of income -- and when I say "best measurement of income", that is what the managers choose to call it.

MR. BROWN: And the chartered accountants.

THE CHAIRMAN: I think we would all agree that is the best measure. Then, anything over that surely must be liberalization. Nobody quite knows how much that amounts to, but it has been suggested -- and certainly this is without any support at the present time -- that there must be as much as a billion dollars. That is cumulative, of course, over the years. If that is so, the cost, of course, is the interest on that because the government is out the interest on the taxes it did not receive and industry is in the interest because of the money it has obtained without interest. Perhaps that is very fair and very

reasonable; I do not know; I am not trying to make a judgment on it. How much further would one go? What is desirable?

MR. BROWN: First of all, I think this clause needs a little interpretation. We have discussed this and we discussed it last evening when trying to anticipate these questions. We have to take it in context and I think primarily we are talking of the normal not the accelerated capital cost allowance.

THE CHAIRMAN: I was.

MR. BROWN: Yes. I think we felt by liberalization we were also implying broadening, so that all taxpayers had the same privilege. In other words, under this accelerated set-up it is qualified, restricted, is it not?

THE CHAIRMAN: You mean so far as depressed areas are concerned?

MR. BROWN: Yes, and also in the case of accelerated it applies to corporations, and we felt it would be more equitable, and that if it is going to serve the purpose for which it was put in, then it should be applied across the board. All industries should have the opportunity to take advantage of this thing. We are talking about the economy, not of segments. As you say, it is difficult to say how you measure liberalization. It is like saying how high is up; but if there is some validity in the belief that by increasing depreciation allowances investment in industry is

stimulated and the economy thereby, and the contribution to economic growth, is enhanced, it seems to us that we should be leading in the direction of liberalization and not in the other way. This is a pretty generalized explanation.

THE CHAIRMAN: Have you any views whether there is need for further investment in industry? We are told that any time anyone appears before us but I do not know that it is well supported. The construction industry, of course, say it would provide more jobs -- and that is a very valid objective.

Are our tools for production old at the present time? Are they getting older or are they getting newer?

MR. BROWN: I think both. I can think of our own industry in which the pace of technological change is accelerating. There have been more changes in the last ten years than in the previous 40 years. We have a mill that is still good from a physical standpoint; it may have been installed ten years ago. However, the industry has gone ahead of that so far that we have to scrap it and we have to get another one to remain competitive. The change is just too rapid; the change in the customers' requirements is too rapid. Production of tin plate, for example, to compete with aluminum containers requires the introduction of new, very costly mills. We may have put in a new mill five years ago, but if the American Can

Company and customers such as that demand this particular type of tin, we have to put the mill in regardless of whether we put our present mill in yesterday or two years ago. This is going on throughout our industry and I think in other industries.

I think there is a need for continued investment. We make this statement, and I think it is true, that we are going to continue to need large sums of money to keep abreast of the industry. If the Canadian steel industry is going to remain competitive with other steel industries, then we are going to have to invest; we cannot escape. We have to invest more and more money in capital equipment.

THE CHAIRMAN: Is an abatement of taxation a tax incentive to you, or does abatement of taxation cause you to be more up to date in equipment?

MR. BROWN: Definitely, yes. I think it is proven. You only have to look at the record. I think the capital cost allowances in Canada have favoured and encouraged and stimulated the development of the steel industry in comparison, say, with that of the United States. I think that our more liberal cost allowances in Canada have encouraged investment in Canada as contrasted with investment in the United States. If the American laws are liberalized, if they are going to give more concessions to their industries, then perhaps some of the American companies with subsidiaries in

Canada may decide to put their money into American plants.

THE CHAIRMAN: That is a very interesting statement indeed, Mr. Brown. We, of course, are concerned that incentives are not given to one industry to too great an extent as opposed to other industries.

COMMISSIONER PERRY: Mr. Brown, would you be able to say whether this is because of the effect of your ability to go ahead on your cash flow, or your incentive to make the investment because of prospective greater return?

MR. BROWN: Perhaps it is part of both. First of all, there is the incentive; and, secondly, there is more wherewithal to do it. I think liquidity has an important bearing on investment decisions.

THE CHAIRMAN: When you come to consider a major expenditure on plant do you develop the results of that, presumably to show the return you are going to get on that particular article or program? The net return is after tax, I would assume?

MR. BROWN: Yes.

THE CHAIRMAN: You would also develop the cash flow, would you not?

MR. BROWN: Yes.

COMMISSIONER PERRY: You run the gamut of views on this. You have people saying, "We are not worrying about the money; we can get it. It is just whether it is worth while to make the investment".

MR. BROWN: I think it is a little of both. First, you start off with the need. I am not sure that incentives by themselves will encourage people to spend money if it is not economic. We made calculations when this recent budget came out. Superficially, it looked as though it would be a

good idea to go out and spend money rapidly, all you could, right away, and get everything in, and thus take advantage of accelerated depreciation, because it is limited in time. However, when you come to compute the cost of money and the benefits, you find that unless there is in substance an economic reason for going ahead with the project, it does not pay, and you do not gain enough by accelerated depreciation to offset the cost of a machine standing there for two or three years before it is needed.

MR.PLACE: I think the measurement of time is a particularly important measurement. Mr. Brown has been speaking in the complex of the steel industry. In the chemical industry, where there is a high rate of obsolescence, certainly the question of time is important, and the period required to recover your investment is an important factor in any calculation of whether or not you make an investment.

COMMISSIONER GRANT: I think it is interesting to note in this connection that the three companies which are represented here this morning have raised money within very recent years through the sale of common stock to the public.

MR. PLACE: We have not.

COMMISSIONER GRANT: You have made your stock available to the public by listing it ?

MR. PLACE: Yes, but it has been available for 4 years.

COMMISSIONER GRANT: However, Shell Oil --

certainly the Steel Company of Canada has made its stock pretty popular to the public.

MR. BROWN: Thank you.

COMMISSIONER GRANT: By splitting.

What I was coming to was this, when you need additional capital, do you think in terms of raising it through the issue of common stocks, or are you more in favour of debt financing?

MR. BROWN: This is a pretty broad question. It depends on the circumstances. Again, it is a question of the cost of money, the cost of funds. You have to take a pretty broad view of this thing: is it more economical to raise the money you need by selling stock? There is a disadvantage in that the cost is not allowable for tax purposes. Is it better to raise it through the sale of bonds, in which case, theoretically, it costs you half of the interest rate. On the other hand, you have a fixed charge. I think the financial people go through a lot of calculations to determine which is the best medium of financing a given project in a particular set of circumstances. It is pretty hard to make a categorical answer to your question.

COMMISSIONER GRANT: I did not expect you to.

MR. PLACE: The time element is also an important element in the question of raising capital. In other words, is this a permanent need for additional capital, or a temporary requirement? This factor is also considered in determining whether

you raise debt or equity capital.

THE CHAIRMAN: Going to 8(b), in which you deal with the research incentive. We have heard this before, that the base is not entirely satisfactory because it discriminates against the person who has been making expenditures. On the other hand, I might say we are conscious of the fact that in the case of an incentive it is a matter of taking money away from one group of taxpayers and giving them to another group of taxpayers. So, obviously one should seek to obtain the maximum benefit with the minimum amount of concession. What is attempted here is to increase certain expenditures over what they have been in the past. Would we not be doing it better by permitting them over a base? Is not that going to be more effective, and are we not going to get more for our money? It may be rough on certain people and uneven, but surely we are trying to get the best return on the investment of our tax money?

MR. PLACE: You said in your question this was a question of taking money from one taxpayer and giving it to another.

THE CHAIRMAN: That is what any incentive is designed to do.

MR. PLACE: I do not think this is quite correct, in our view. The basis of any research is the economic return you expect to get from it, as far as an industrial corporation is concerned.

We are not philanthropic enough to spend money on research with no anticipation of a pay-back. To expend large amounts on additional research being performed by a company, or research where there was not any before, this is all done not with the prime objective of realizing that incentive, but with the objective of an eventual economic pay-off. That economic pay-off results in higher corporation taxes, so the incentive is perhaps something of a reduction in the amount of tax you will eventually pay on the pay-off from that research; but I do not think it necessarily swings the tax burden from that taxpayer to another taxpayer. Research is done, in fact, in anticipation of improving earnings, and, in consequence, paying a higher tax at some future point of time.

THE CHAIRMAN: You may be correct, but I continue to think of it as a shift between taxpayers for a good purpose, and it is to get the economic pay-off.

MR. PLACE: Speaking from the chemical point of view, what the incentive permits us to do is to increase the rate of research work at approximately the same cost. In other words, it may affect the total amount of research you do, it may affect the type of it and the timing of it, but it does not affect the question of whether or not you are going to do research. Our business is dependent upon research, and we would disappear if we did not do it. This permits us to increase the pace

of the research work at approximately the same cost, in the expectation that it will yield a pay-off and it will increase the over-all effectiveness of the operation.

THE CHAIRMAN: Would not that result if the tax reduction pertaining to your expenditure were related to a base?

MR. PLACE: Yes, it would have somewhat the same effect, but it would not permit you to increase at the same sort of pace. As yet, nobody has devised a method of relating the amount of research work you should do to the sales level or any other level. There is no sure way of measuring whether you are doing the right amount or not. On the other hand, a corporation is limited in the amount of research work it may do by the amount of funds it has available. If the government increases those funds by means of an incentive, then the corporation is permitted to increase the amount of research work it does. To the extent it increases it, presumably you advance the period when the results of that work are available, and it results in a longer earning period for the effect of that research work. So our belief is this is a question of timing, and if the research incentive were handled in this way it would result in a further incentive, and a much more effective incentive than the present one of relating it to the base period.

THE CHAIRMAN: I am also impressed with

the fact that the advancing of research work will provide jobs for research people which perhaps otherwise would not be available.

MR. BROWN: Under the present system, if the research expenditures fall more heavily in one year than the next year, there is no incentive to go ahead in the next year. You might raise your base to a high peak, and there is no incentive beyond that, and you fall below that base in the succeeding year or years. I think the objective is to increase research activity in Canada. We have not come up to the level of research in other industrialized countries. If that is the objective, it seems to me that by applying it to all research expenditures it will do more to achieve the objective, because it removes these difficulties and uncertainties. Everybody who is going to spend a dollar on research receives the same benefits.

MR. GREENMAN: Yes. We could visualize, though we have no evidence of it, that there might be a worth while company which could be induced to spend more money, but were dealt out of the picture because of the rigidity of a certain base year which happened to be the worst thing for that particular company. It might be a year when they built up a perfectly enormous base, and incentive means nothing to them. Also, theoretically we do have an interest in maintaining the level of research expenditure by people who have carried on at a more or less steady rate through the past years.

The removal of the incentive, because of the base year restriction, might cause them to decrease their expenditures. This, of course, is just pure theory.

COMMISSIONER PERRY: I suppose the government was trying to get the bargain here, with the 150. You suggest it might be reduced. Do you have any idea how much the 150 might go down to save a little money?

THE CHAIRMAN: That is what I was trying to do too.

MR. PLACE: I think all of us could answer that with respect to our own companies, but not with respect to industry as a whole.

THE CHAIRMAN: We will stand over for ten minutes.

--- Short recess.

THE CHAIRMAN: I think we might start. Going to paragraph 9 which deals with matters in the area of assessment which you say is a matter to which you refer as the rate of interest and the fact that the interest which one pays to the Government is not deductible and therefore it becomes the equivalent of a commercial interest rate of 12 per-cent. You recommend that the interest rate be allowed as a deduction from taxable income and then you have referred to the fact that it should be limited to 12 months following the date of original assessment.

Taking those separately, I am inclined to be a little contentious about this matter of interest although I have often thought that 12 per cent was a pretty high rate but the Government is not lending money in this matter of income tax. I think it should be a pretty high rate. It should be in the nature of a penalty, I think. There is no choice as to solvency. And if it were a deductible item I would think that many people would then deliberately not pay their tax in order to borrow the money.

Certainly all these people cannot borrow money at six per cent, who would have to pay the commercial rate of more than six per cent, would be very foolish not to extend their cash payments as long as they are able to do so. Would that not be so?

MR. BROWN: One of the delays is due to the Tax Department, not to the business.

THE CHAIRMAN: Well, can one ever be

sure that the delay is due to the Tax Department. We have a self-assessing basis for taxation where it is our job to determine our own tax and make payment at a certain time on the tax. I agree that the the Act is not as clear as one would like to have it, so it is perfectly clear how much one should pay and frequently the Department says we have erred and we should have paid more. Can you blame the Department for that? I think it is probably our error, is it not?

MR. GREENMAN: Our main thing is the manner in which the innocent are caught along with the guilty when we talk about reassessment and the delays. We, in our company usually are painfully aware that we are paying for something that is still arguable. We have perhaps had a hot argument with the assessor, with the local supervisor and we do not feel like making a case out of it to the Board or the Courts so we think this is sort of a pay-off in which some of the payments do represent a compromise. You know "we will give you this, if you will give in on this one" so we have the vague feeling that almost everything we pay is a sort of businesslike compromise rather than an error, deliberate or otherwise, and so this colours our thinking inevitably.

THE CHAIRMAN: I am not sure that one can fairly say that it is ever really the fault of the Department in these matters. It seems to me it is the fault of the Parliament very often because

the law is not simple and clear enough. On the one side we have the assessor doing his best to get as much as possible and the taxpayer trying to pay as little. It falls probably somewhere between.

I would think that there would be a pretty strong incentive to pay up the full amount and not make this kind of money available to people compared with the ordinary commercial borrowing.

MR. KARR: I don't know whether we would go that far, Mr. Chairman. We do say we realize a deterrant against borrowing is necessary. All we are suggesting there is there should be some mitigation of this. This does not necessarily mean bringing it down to the six per cent commercial rate or something.

THE CHAIRMAN: Perhaps your second provision will do that, will it? Restricting the amount of interest to 12 a month.

MR. KARR: That would help, yes.

THE CHAIRMAN: I am not sure what that means. Does it mean if it takes two years to adjust your return they can only charge interest on one year? It doesn't mean if you take more than the year to pay your tax because you don't want to pay your tax, you have not got the money, the Department is restricted to one year's interest.

MR. ROSS: Do you mean if we actually filed the return showing a tax provision and did not make payment?

THE CHAIRMAN: I suspect that quite a

few people do.

MR. ROSS: That would probably be a different matter.

MR. KARR: I think the suggestion is that a delay be on 12 months is very likely to be due to the Department of National Revenue not assessing you. A 12 month's period in assessment seems to be a reasonable time to complete the job.

THE CHAIRMAN: You are thinking about your own members. I would think that it is probably quite true. I must say I am not just thinking about your own members. I am thinking about all taxpayers.

MR. PRICE: I think, Mr. Chairman, our intention in that submission was that delays beyond 12 months due to assessing problems should not carry penalty interest. If the delay was a delay on the part of the taxpayer in making payments, my belief is that he should pay interest and probably 12 instead of six per cent.

If the delay is a delay of mechanics then the taxpayer is being unduly penalized by paying interest at this rate which carries on indefinitely.

THE CHAIRMAN: Now, you refer to this matter of nil assessment and establish the amount of loss. You recommend that the Department shall assess the nil return in the same way as it assesses the return for income shown on it. I suggest the only objection to that is the amount of

work, is it not?

MR. BROWN: Yes.

THE CHAIRMAN: In most cases the returns have to be dealt with anyhow.

MR. BROWN: Yes.

MR. ROSS: It does leave any loss carried forward completely fluid until the end of time, and years have gone by and it is very difficult to reconstruct consideration and so on. One doesn't really know what one's position is in the interim.

MR. BROWN: It discourages trading for loss.

THE CHAIRMAN: I cannot think of very many good arguments against what you propose. I suppose there are some I have overlooked.

Moving on to sales tax. You join those that would bring the tax to the retail level and accordingly a lower rate. You would broaden the base and you would endeavour to obtain uniformity between the Federal and Provincial sales tax. You have undoubtedly considered the problems that arise in moving to the retail level. I think these problems are generally cited here by Mr. Walls. He probably would like to do it again.

COMMISSIONER WALLS:

First of all I would like to ask about the submission at the beginning of the paragraph. "The Federal sales tax is imposed at the manufacturer's sales level and is therefore hidden from the vast majority of tax-payers".

Now, that is the only argument that I see as to why you want to go to the retail level. Was that the only reasons, first of all that you decided on the retail level, to make the tax visual rather than hidden.

MR. ROSS: I would think we could also rephrase the second sentence.

COMMISSIONER WALLS: Yes, in regard to the inequities or anomalies. I will deal with that later.

MR. ROSS: And the discretion. It has to be administered by discretion really because of the complexity.

COMMISSIONER WALLS: You do realize if you move this tax forward, it has been estimated that the 11 per cent sales tax at the present time would have to be in the neighbourhood of an eight per cent tax at the retail level for the same amount of revenue. You add to that an average of a five per cent Provincial sales tax which we have at the present time. This is now 13 per cent.

There is also the point that if you move the tax forward what are you going to do about excise tax, which is also a form of sales tax. In other words, it is an increased rate on a number of

other products. Some are 10 per cent and some are 15 per cent. If you convert them in order to bring the same revenue in at the retail level, they would have to be moved from 7 to 11 per cent additional taxes, so now you are going to have a visual sales tax somewhere in the range from 20 to 24 per cent. How acceptable do you think that is going to be to the consumer if it is a visual tax?

MR. BROWN: Is the consumer paying that now?

COMMISSIONER WALLS: Yes, they are paying that now. How acceptable will that rate be?

MR. BROWN: As a consumer I would be very much annoyed but may be that is what is needed.

MR. GREENMAN: Yes, but by broadening the base and including services ---.

COMMISSIONER WALLS: You have not said anything about services.

THE CHAIRMAN: Yes, they have.

COMMISSIONER WALLS: If you broaden services ---. On the other hand, of course, there are so many people that are asking for a reduction in the other taxes that broadening of the base to services certainly could only partially take care of these other requests.

In regard to your second point here as to your reasons for moving it to the retail level, do you not think that you would encounter almost as many inequities and anomalies if you attempt it, by statute or by regulation, do define the notional

wholesale price and conditional exemptions?

Perhaps a clear definition of sales price and working from a formula and outlining a regulation as to how to establish whole price might help but I don't see how you can define things so rigidly that you are not going to create further inequities. I think you have got to have somebody that is going to define in various industries what shall be the base of tax.

MR. KARR: You are always going to have that sort of thing, sir. There is no doubt about it. We do think that there is a great deal to be gained when you consider there are approximately eight sales taxes across the country -- there is a great deal to be gained by first of all doing whatever can be done to bring about all these into line and secondly to combine, if possible, the collection of these under one group of people. This to me is simplicity. It should also result in, I should think, a reduction in the cost of collection.

COMMISSIONER WALLS: We are talking about two different things. I was trying to get away from some of the points which I think you were referring to as to some of the anomalies that we have today in the manufacturer's sales tax. I thought you were referring to the fact that if it was continued that perhaps there should be more definite delineation by statute or regulation and overcome the problem by working in co-operation with the provinces. There certainly can be no criticism of

that but what is your alternative if the provinces say they do not want to combine in sales tax?

MR. KARR: Of course, we did not cover that in our brief.

COMMISSIONER WALLS: No, not many people do.

MR. PLACE: Perhaps Mr. Chairman I could make a comment of an example which came to my knowledge in another capacity in the city of Montreal with respect to a hospital which we were building. This hospital was being built at a fixed price contract. By law it is exempt from Federal sales tax but we have found it impossible to avoid the payment of sales tax because of the fact that the main contractor buys from a sub-contractor who buys from a sub-contractor with a sales tax included price and in the present method of applying sales tax we are paying sales tax despite the fact that the law says we do not have to pay sales tax because of the way in which it is built into the price structure.

THE CHAIRMAN: You might be interested to know, Mr. Place, that the other day the Canadian Construction Association appeared before us and they recommended that contractors be licensed or have a sort of a license, I suppose, is what they were after because they wished to work out the rates of tax for each type of construction, having regard to the legal approach to the building which would tax materials in the building and not labour. Of course, if that were done they would then be paying

one tax over to the Government on that building and it would be very easy for the hospital to obtain a rebate of that tax.

MR. PLACE: Yes. I can think also of a particular case where lumber was used for form work. The main contractor had subletted the contract for cement foundation work to another contractor who in turn is buying lumber on a sales tax included basis, which is the only way apparently the price is quoted.

But by the time that goes through four people and the hospital eventually pays for it, we have not been able to trace back the amount of the sales tax.

COMMISSIONER PERRY: Having heard from them of the problems of the contractor who is building a bridge over the Ottawa River in Ottawa and is dealing with three authorities, I don't think you can really tell us much more.

MR. PLACE: I am sure I cannot.

COMMISSIONER PERRY: He has every problem you could think of.

COMMISSIONER GRANT: I can certainly corroborate your evidence with the hospital because I think in my own experience I don't believe we recovered, if we recovered one-third of what technically the law says we should recover, that would be as much as we got.

MR. PLACE: Our point is that the present construction of the law is such it makes it impossible for you to achieve the position that the law says you can achieve.

COMMISSIONER WALLS: There are two ways it can be done. They can license each of the various sub-contractors and contractors and they can get their goods tax free and then treat it as the Contractors' Association suggested on the end use, which is the same as the manufacturers do.

Practically every manufacturer pays tax on the final end use with the exemption to the contributing manufacturer on the final product. The other alternative to that is that the people buying these goods pay the tax and then apply for an exemption under the new regulation.

On that basis even if they would accept the statutory exemption from the contractors and sub-contractors that this was for the hospital, they would not have to pay the tax in the first place and they would then not require the hospital to pay on the final exemption.

MR. PLACE: I have used the hospital simply because it is a very concrete and tangible example. The same thing does go on in other areas.

THE CHAIRMAN: May I put a question?

COMMISSIONER WALLS: Yes.

THE CHAIRMAN: There are, generally speaking, suggestions made as to three levels at which the tax might be applied, and the retailers have recommended that it be at something else than retail and the wholesalers that it be at something else than wholesale level, and so on. If it is not possible to place the tax at the retail level because of difficulties which may emerge in the future -- I do not know what they are or if there are any difficulties -- and it just is not possible to do that, do you have a choice really as to where the tax should be? I know it is not in your submission, but have you thought about it? Have you thought about whether it is best to have it at the wholesale or retail level? You must have had a fair amount of experience.

MR. GREENMAN: I do not think we would see much to be gained by moving it from the manufacturer's to the wholesaler's level. I think our recommendation is all the way.

THE CHAIRMAN: Paragraph 12 is the next.

I think it is interesting to see what you say in paragraph 12 about further co-operation in the budget and that you believe there has been over-emphasis on budget secrecy. Have you really considered how there might be a closer liaison between

business interests and government in the matters of taxation? Have you thought of any formal means of achieving this? Do you mean public hearings? Is that what you are thinking about?

MR. BROWN: I think on very fundamental changes, yes. On others, I think Mr. Gordon has perhaps opened the door for the opportunity for people to come to discuss these things before the budget is prepared; at least, that is my understanding. This was written, or at least the idea was conceived, before there was an expression of opinion from him about this very matter. I think there is an indication now of willingness to consider some of these ideas and perhaps to have established the principle or at least the philosophy, the concept that ways and means can be worked out whereby the more fundamental changes could be aired in advance -- not before the next budget, but looking ahead.

In some respects I suppose this Commission serves that purpose in airing fundamental issues.

THE CHAIRMAN: There has always been the opportunity, of course, for presenting one's own thoughts to finance ministers, and as you are probably aware many have taken advantage of it.

MR. BROWN: We do that, yes.

THE CHAIRMAN: I believe you are rather saying to us that where the government contemplates some major changes they might take the initiative.

MR. BROWN: That is right -- some kind of

forum where these matters could be discussed.

THE CHAIRMAN: I would think publicly rather than privately.

MR. BROWN: Yes.

THE CHAIRMAN: If it were publicly, there would need to be some kind of public hearing such as this.

MR. BROWN: Yes.

THE CHAIRMAN: It has been pointed out to us that this must not in any way diminish ministerial responsibility. I would have thought that in order to preserve that responsibility we could not go very far towards the American system; it would have to be the kind of hearing which was advisory and which might be within a department. Have you any suggestions?

MR. BROWN: They might be very broad in coverage and they might primarily be for the purpose of testifying as to the possible, probable or potential impact of changes contemplated. Would that not be its chief advantage?

None of us in industry -- and I am speaking for myself -- sees the whole picture. We are not in a position to do so. We can testify, however, as to the impact of these things as we see it and leave it to someone else to put the pieces together, to put together my testimony and someone else's testimony, and at least get the benefit of practical experience in regard to the possible effects of fundamental changes in law which may be contemplated.

We are trying to avoid the situations which we think arose following the last budget.

THE CHAIRMAN: Would you come forward annually with a submission such as you are now putting before us?

MR. BROWN: If the issue were important enough, yes.

MR. ROSS: One has to have an idea of what the government proposes. Making a submission just shooting into space is not very productive, but if we knew the general lines we could offer opinions. There have been instances where government has put in a budget and then has withdrawn it because it was found to be unworkable -- the withdrawal coming as a result of people pointing out the effects of which the government was not aware.

THE CHAIRMAN: I would have thought it would be useful whether or not you had any inclination of government proposals -- and more useful if you did than if you did not, but surely one cannot expect to secure the best laws -- and when I say the best I mean those most suitable for the country and its people --without people expressing themselves as to the kind of laws which they would like. Of course, that is one of the advantages of public hearings of a Commission. It would seem to me as one goes on year by year expressing views regarding the laws there is bound to be an impact made and the laws will over a period of time do their best to

conform to the collective views as so expressed. Would that not be true?

MR. ROSS: Most of us belong to the Chamber of Commerce or the Institute of Chartered Accountants, and in one way or another we do make contributions to their annual submissions. Whether another one would be adding very much to the situation I do not know, but if we had some idea what the government contemplated we might be able to give some very helpful advice on occasions.

MR. GREENMAN: We can think of some examples when new provisions have been put in the budget speech which, it rapidly became obvious, were poor and they had to be withdrawn when everyone rushed to Ottawa to point out what should have been pointed out before the budget speech.

One that comes to mind is the imposition of the 40% tax on pay-outs of lump sums of our pension plans. This was ill-conceived, and as soon as the government heard the obvious objections it was quickly withdrawn. This is the sort of thing that comes to mind when we say that if we have an idea of what they were planning we could all contribute at that time before there is embarrassment for anyone.

COMMISSIONER PERRY: There is a real point here as to just how specific the government's approach would have to be. Suppose as an alternative it were to say that we are thinking of doing something substantial about, say, personal corporations

or undistributed surplus, or something of that sort, and we will receive representations on this subject. There is a danger in the consideration of a specific proposal, of course, that all the evidence would be negative, simply that people did not like what was being proposed and would come down and say so, and not feel it their responsibility to make any alternative suggestions.

MR. KARR: In that case, of course, you do at least have the opportunity of presenting your views. Your views may not be accepted. This is what is missing now.

MR. GREENMAN: I could see it operate in the one specific case I mentioned. All they would have to do is tell us they are tired of the section 36 procedure on lump sum payments which involved the trouble of computing the average of the last three years, the average tax rate, and that they would like to make it a flat, graduated scale. If they said that was what was in their minds for the next budget, that of course would invite a consideration of all the pros and cons.

COMMISSIONER PERRY: It might not elicit very much for alternative approaches.

MR. GREENMAN: On this narrow example, I think people would have been quick to point out that even though very large sums might be involved in pay-outs, the graduation should not be extreme because a working man could receive twenty-five or thirty thousand, perhaps, under such circumstances,

and therefore obviously a high rate of tax applied to that would not be fair. This is something that was completely forgotten by the draftsman of this particular tax.

COMMISSIONER GRANT: Sometimes discussions develop more heat than light, and there could be a queue forming up right down to Rideau Street to be heard on some very controversial things, but that does not in itself rule this out as a forum, as a platform to discuss it.

COMMISSIONER PERRY: I think the need is for a vehicle for bringing forward intelligent examination. Whether you get it through putting forward a specific proposal and say, "What do you think of this?" or whether you offer an area in which you are proposing changes and asking for suggestions as to what the changes should be -- what you need is the vehicle.

MR. BROWN: Maybe we need to experiment. Perhaps we should try something like this. It may not be perfect in the first stage.

THE CHAIRMAN: The Commission indicates to me that one gets all kinds of suggestions. We have had complete tax systems and suggestions on every subject I can think of. Certainly they have been on both sides and of both qualities, but there has been no holding back.

COMMISSIONER WALLS: I would hate to think of the Minister facing up to 335 briefs!

THE CHAIRMAN: Is there anything further?

Thank you very much. I think this exhausts our questions. This has been most worth while indeed. You have been very helpful to us. We are extremely grateful. It is nice to have seen you.

THE SECRETARY: While Mr. Gilbert is still with us I would like to enter two briefs. The first is a supplementary brief of the Investment Dealers' Association of Canada.

EXHIBIT 342: Supplementary Brief, Investment Dealers' Association of Canada.

The next is a supplementary brief of the Equitable Income Tax Foundation.

EXHIBIT 343: Supplementary Brief, Equitable Income Tax Foundation.

The next item of business is a continuation of an examination of the brief submitted by the Canadian Institute of Chartered Accountants, Exhibit 288.

EXHIBIT 288: Brief, Canadian Institute of Chartered Accountants.

THE CHAIRMAN: Good day, gentlemen. We are glad to see you back again. Thank you very much for returning. I think it was a good move to have deferred sales tax -- not that we had much choice

G-9

at the time. However, it certainly has provided us with the opportunity of bearing down on that particular part of the brief a little harder. I certainly read it over again to refresh my memory, and I found a lot in it.

I think we turn now to page 90.

MR. LITTLE: Mr. Chairman, before you start the questions perhaps I might just reacquaint the Commission members in case they have forgotten as to the respective roles of those who are here with me. We constitute a small part of the larger committee which was here before.

Mr. Philip has acted as permanent secretary to our special committee throughout all its work. Mr. Gerald Townsend appeared at the preliminary hearing as our expert on sales tax. However, in the meantime he has taken a very important position with the Ontario Committee on Taxation and as a result, while he graciously agreed to come, we hope the burden of his replies might rest with someone else and we hope this will be Mr. Eric Ford who is on my left who, while not an original member of the Committee, was seconded by us to deal with this one major area of sales tax. On his left is Mr. Thomas, the Chief Executive Officer of the Canadian Institute of Chartered Accountants.

Throughout the balance of the hearings, while we will help to the extent that we can, we will look to Mr. Ford to carry the burden of replies to your questions.

G-10

At this point I might say that on page 90 we should correct an error on the first line. We are referring to the Excise Tax Act and not the Excise Act.

THE CHAIRMAN: Thank you.

I do not think we need to discuss the different types of tax. I am glad, however, you put them on record. I think it is a useful discussion of them, as well as your reference to the added value tax where it fits. You say:

> "It would therefore appear that a change in the type of sales tax levied by the Canadian government should only be considered if the point at which tax is levied is changed, and the choice would then lie between the single stage tax and the added value tax."

We subsequently dismissed the added value tax, so that you come down and say that if the point is changed it should be a single stage tax. That brings you to the conclusion, I think, that on balance as between tax at the manufacturer level and tax at the retail level, you believe that fairness dictates the latter although perhaps economy in the collection of the tax favours the manufacturer's level as there are less collectors and fewer people to deal with, and in fact it is a very cheap and economical tax to collect. However, as we all know, it has some difficulties.

You, however, say that it would appear that the federal government should only change to the retail level if it gained the co-operation of all the provinces. We have had people say that irrespective of co-operation of the provinces the tax should be shifted. That would mean that merchants would have to deal with two taxes.-- if they had a cigar box for provincial tax they would have to have a second one for federal tax, and so on. I suppose the people who have suggested this take the view that if this was done common sense would eventually dictate that the two would come together, perhaps eventually would be forced to come together. I gather that you are of the view that if the federal government said they were going to impose the tax at the retail level and were going to proceed to collect it themselves, it would be a very costly operation and a pretty inefficient one.

MR. FORD: Yes, sir, there are two basic problems. First, there is the small retailer who does not keep adequate records and with whom the provincial governments now deal on the cigar box or milk bottle basis. Having two cigar boxes or two milk bottles seems to us to be a silly provision. In addition to that, there is the problem that unless you have uniformity of the tax across the country -- that is uniformity of exemptions particularly -- each retailer will be faced with two separate taxing statutes with varying exemptions and provisions which may give rise to severe

administrative problems for even the largest and smallest of the retailers.

THE CHAIRMAN: Would those problems be worse than what goes on now where we have two taxes? It is true they are at different levels. We have two, and the two we have now have different rules.

MR. FORD: I think it depends a good deal on the differential of the exemptions as between the federal government and the provincial governments. For example, most of the provincial governments are now exempting children's clothing, and this is according to a certain size. If the federal government were not to exempt children's clothing the retailer would be faced in every case with the position of having to remember that he had to collect federal tax on children's clothing and not provincial tax.

THE CHAIRMAN: He would put a tag on the goods.

MR. FORD: He could, but the situation would become morecomplex if the provincial government and the federal government failed to agree on exactly what size standard constituted children's clothing. It is this type of problem we are afraid of.

THE CHAIRMAN: And that is what led you to your recommendation? Are there any other considerations that lead you to the conclusion that without co-operation we should not move to the retail level?

G-13

MR. FORD: I think the other major consideration would be that there does not seem to be the same advantage from the government's point of view, from the administrative cost point of view, in moving to the retail tax unless there is a co-ordination of the provincial and federal taxes. In other words, the retail tax is undoubtedly more expensive to administer, and I think the experience of the provincial governments in administration costs probably shows this.

If there is no co-ordination between the federal government and the provincial government, we simply have a compounding of that more expensive collection procedure without the administrative advantage of having only one collector.

THE CHAIRMAN: Is the provincial tax fairly expensive to collect? I have seen Professor Due's estimates, which I think run up to about 3%, but it occurs to me that the whole machinery of collecting provincial taxes may not be engaged up to now. There is more auditing required probably and more enforcement procedure.

MR. FORD: I think the difficulty on the statistics available at the moment is to determine exactly how expensive the retail sales tax is now to administer. We have the problem in the provinces that compensation is paid to retailers for collecting the tax. If this is part of the combined federal provincial tax we are recommending, this of course raises the collection costs. Secondly,

I think very few of the provinces are as yet doing a satisfactory job of auditing the returns of vendors and that most provinces are going to have to set up collection procedures in future so the present cost figures may be on the low side.

THE CHAIRMAN: There has been no estimate made as to the losses and as to the efficiency of the collection?

MR. FORD: I cannot recall exact figures. Professor Due, as I remember, believes the efficiency is underestimated rather than the other way round, and that in fact most taxes are collected by responsible retailer organization; that the number of retailers who would fail to collect tax or would commit fraud on the sales tax is quite limited and that the amount of tax evasion at the provincial level is probably overstated or over-estimated.

THE CHAIRMAN: I had an idea that about half the retail business was done by small merchants.

COMMISSIONER WALLS: I believe the percentage is higher. I believe it is 90% according to the figures we have -- 90% of the retail business is done by what is recognized as small retailers.

COMMISSIONER GRANT: The Retail Council said they had something like 22% of sales.

THE CHAIRMAN: Anyway, a large part is done by small merchants. I wonder why Professor Due would conclude that they were fairly secure because of their being collected by larger merchants.

MR. FORD: I think there may be a question of interpretation of a small merchant versus a large merchant, and in addition there is probably the factor that a good many small merchants probably do keep very good records.

. 23

COMMISSIONER GRANT: I heard the administrator for Nova Scotia deliver a topic statement in which he said the loss was much less than anticipated; he thought it was not any great factor. He may have been prejudiced in his views, but I think he was giving what, at that time, would appear to him to be the facts.

THE CHAIRMAN: You set forth the advantages of your recommended change in paragraph 275, where I am now. Has anybody anything before that?

COMMISSIONER WALLS: Where are you?

THE CHAIRMAN: This is paragraph 275, page 97.

COMMISSIONER WALLS: Yes, I have some questions before that. The first thing, it seems to me, is that you indicate you feel a greater emphasis should be put on sales tax, mostly based on European experience. On page 91 you first of all deal with the fact that under 20 per cent of our tax revenue comes from sales tax. The only thing I would draw to your attention there is that your figures are actually fairer than most that are put before us; but under sales tax you did not include the excise tax, which is another form of sales tax. They carry an additional 10 or 15 per cent. Excise duties should be included in there, but I do not think excise tax. If you add that, you find that instead of being under 20 per cent in the year you quoted it was 23 per cent, and in the following year, 26 per cent. So there is actually a higher percentage than the one you quote.

When you make the comparison, on page 92, generally speaking European countries rely more heavily on sales tax, are you not ignoring the fact that in most of these countries they have a single government form of tax, whereas when you add our provincial sales tax, it brings us up relatively high among all the countries in the amount of sales tax?

MR. FORD: Yes. I am sorry that in our statistical work we did not make any attempt to draw together the total national sales tax at all levels of government and attempt to compare that.

COMMISSIONER WALLS: I wanted to make sure, because this is built on the premise we tax commodities much less than other countries. You are basing a lot of your philosophy in your whole brief on that. I think perhaps you agree we are not very much under these other countries, with the possible exception of France, percentage wise.

MR. LITTLE: Talking about the philosophy of the whole brief, I think we came to the conclusion that the rates of corporate tax and the progressive rates of personal tax were now too high. In our recommendation that we shift to the retail level of sales tax, we assume the rates would go down, as they would obviously do, in producing the same amount of revenue. But our philosophy on suggesting the increased revenue from sales tax is only if it becomes necessary to raise more revenues to finance more expenditures. What we are really saying is that we do not want increased taxes of any sort; but if we must choose

between them we say this is the route we think is the better route to go.

THE CHAIRMAN: I appreciate that.

COMMISSIONER WALLS: I have one or two questions on page 95. You state:

"Frequently where no wholesale market exists for domestically produced goods, the sales tax broadened on imported goods may be lower than on competing domestic goods unless complicated valuation rules are introduced."

We have heard a great deal about the inequity that there exists between imported and domestically manufactured goods. What would you think of a flat charge being put on all imported goods, to bring it up to the equivalent of the wholesale price or the price the manufacturer -- the cost he has to entertain, such as financing advertising and certain freight charges, and so on? There is one country that does that. Do you think it would be fair, from the standpoint of comparison between various types of goods, and would that be overcome by the fact you save so much on administering by putting a flat charge, which would get away from your problem of complicated valuations.

MR. FORD: It seems to me the flat charge would amount to a customs impost of one sort or another, rather than a sales tax of general application. Apart from that, it seems to me you would

have some administrative problems in determining exactly which groups should be subject to this charge. It would depend on the status of the importer. If it was a retailer who was importing, you presumably would not put the impost on; whereas if it was a wholesaler you would. I have not thought enough about it in the past so I can come to any firm conclusions on it.

COMMISSIONER WALLS: In your next paragraph, on page 95, you say:

"A tax levied at the wholesale level"

-- you agree the same amount may be raised at a lower rate of tax or since the tax base is larger, but it is subject to the same type of distortions. Surely, you would admit it is subject to less of them? Does not wholesale tax really reduce the number of transactions requiring past adjustments, and will not it also eliminate most of the inequities on imports? It does surely also have an advantage over the manufacturers'tax, and to get away from problems of defining "use" ---

THE CHAIRMAN: -- and special brands.

COMMISSIONER WALLS: It avoids different treatment of licenced and unlicenced wholesalers we have under the manufactures' tax; and the same revenue can be raised by a lower tax rate, and more avoidance of pyramiding, so surely wholesale tax has some advantages over the present manufacturers' tax, and you do not find the same type of distortions?

MR. FORD: I think we do find the same type

of problems with the wholesale tax. In the first instance, it creates some additional problems which do not now exist. It creates the problem of the wholesaler who sells to a consumer or as opposed to selling to a retailer. Where we now have no problem with sales of goods direct from the manufacturer to the large retailer who buys in most cases at prices equivalent to the price a wholesaler can purchase them, if it is moved to the wholesale level we have the large retailer buying in bulk obtaining a competitive advantage over retailer buying in smaller quantities. So there is immediately a problem of upward valuation of bulk purchasing from the manufacturer to achieve equity between one class of retailer and another. The same problems as now exist continue to exist in the case of sales by manufacturers directed to consumers. It is simply a difference in the price level, and you have to readjust discounts now granted to manufacturers.

COMMISSIONER PERRY: The discount would become very much less.

MR. FORD: They would become somewhat less.

MR. LITTLE: I wonder if it would be fair to say it is perfectly true, as Mr. Walls suggested, to the extent there is an improvement in the position. We admit this in paragraph 269. At the same time though, the widening of the number of taxpayers involved and the increased cost of administration, we think that with that problem plus the new problems

that are created, they are such that while they do not offset the disadvantages it is not sufficient improvement to make a move of this kind. In other words, our conclusion is we would rather stay where we are rather than make a move to that level.

THE CHAIRMAN: This is a matter of judgment, and we intend to keep on employing it. I must confess that like Mr. Walls, I was a little surprised you came down this way. There may be quite a difference between the tax on the wholesaler and manufacturer level, primarily because of the large number of goods which do not pass through wholesalers, and where the prices have to be adjusted, and every time that happens there is something arbitrary. You take averages, and there are imperfections in any averages: some above, and some below; and there would have to be arbitrary adjustments. It seems to me when one goes to the other level and the price is what the retailer pays for it, there is a much greater area of evenness. I may be exaggerating, because I find some retailers do perform wholesale functions, and it is not fair to put a tax on their purchase price the same as on those who do not perform wholesale functions, without adjustment. It might be those adjustments are just as difficult as the adjustments are now. That is something we have to look at.

COMMISSIONER WALLS: On page 96 you state, in the second paragraph :

"To have two separate retail sales taxes with varying exemptions would

H-7

place a heavy burden on retailers with respect to collection of the tax and would result in very severe problems in those cases where records are not well kept. It is possible to develop simple systems for levying a single tax where records are rudimentary but the whole system might collapse if a second tax was put on at the retail level. It would therefore appear that the federal government could only shift its tax to the retail level if it's going to the corporation of all the provinces."

I want to ask you if you have given consideration to another alternative: That is, a single stage turn-over tax or hidden tax collected from the retailers by the federal government, such as is the practice in one European country, in which they base the tax in most cases on the gross income from sales of the retailers. In other words, it is a hidden retail tax. If the provinces would not cooperate with you on a joint, visual retail tax, could you not have an option of moving your tax forward to the retailer or consumer level, but making a federal tax a hidden tax? Is not that another alternative?

MR. FORD: It may be an alternative, but there are certain problems with that. First of all, it is my understanding there is a large number of

states in the United States which levy a gross revenue tax. In almost all cases that is done separately, and the retailer refused to absorb it without telling the customer.

COMMISSIONER WALLS: In this particular European country they have legislated it is against the law not to do so.

MR. FORD: If it was legislated, it would overcome the problem, and the public would be aware of it.

The second problem in gross revenue tax is the records must be well kept, unless you have no exemptions at all, otherwise the tax becomes quite complicated in regard to trying to determine which part should be subject to tax.

COMMISSIONER WALLS: At least you do get away from the fact you are only dealing with the retailer himself, but if you should go for joint retail tax with the provinces, to get them to co-ordinate their exemptions and other conditions you would then be dealing with not just the retailers, but with the retailers' clerks, which would become an almost impossible problem if you were to attempt to operate a joint tax under different conditions, especially as, without doubt, it would look to me that if you go on joint tax it is going to be at different levels in different provinces, because the provinces have taken that sales tax in some cases for specific properties, and they may have to increase as the weight of demand required.

I now have some questions on page 97.

THE CHAIRMAN: Go ahead.

COMMISSIONER WALLS: You say:

"In order for the tax to be effective it would be essential that the taxing statutes of both the federal and provincial governments should be the same."

-- and I agree, if it were a joint tax.

Have you given any thought to how you would handle retail credit sales? I am not even sure how the provinces handle them. As a tax, is it on the product as initially sold, or take cases where there is no down payment, do they assess it as the payments of ?

MR. FORD: I know of no exception in the Canadian provinces to the role that the taxes are payable at the time of original sale, no matter what the terms, so the tax must be collected at the time of sale.

There is no down payment to the retailer at that point is assuming the credit risk.

COMMISSIONER MILNE: I thi-'- the Retail Merchants brought that up, because they thought this matter of financing would be a real problem to a great number of people.

MR. FORD: I agree, it is a significant problem, if you do have the combined rate.

THE CHAIRMAN: I am not sure that the burden of the financing of that could not be offset

by the release of the financing of the tax on their inventories, which they now have, so they might be ahead.

Of course, you feel this thing is worth while, with the cooperation of the provinces. Have you thought about the pros and cons of the provinces going along with a switch in the federal tax at the retail level? We will try and avoid asking Mr. Townsend this question.

MR. FORD: I do not know of any good reason why the provinces would not go along with the federal government, although I would expect that at least some of the provinces would insist that they have the control over the changing of exemptions, that the federal government's control would be exclusively limited to its right to change rates. Of course, exemptions would be changeable, presumably by consultation with all parties, but the provinces would not wish to give the federal government the right to change exemptions at a moment's notice.

MR. LITTLE: In answering the question, perhaps you want to explain whether you are talking about the likelihood of reasonable cooperation in adopting a common form of tax and common exemptions, as opposed to agreement as to who would in fact collect and administer the tax.

It seems to me unlikely there might be provinces that would prefer to control the collection machinery and remit the federal portion to the federal

government, rather than the reverse. It seems to me this does not seem to destroy the validity of the proposition.

THE CHAIRMAN: I have wondered how the provinces would avoid the blaming of the tax on the federal government and collecting themselves. They would not want to be saddled with a 13 per cent tax. There may be a perfectly simple answer to this, but I have not up to now thought of it.

MR. FORD: I would have suspected the ingenuity of the provincial politicians would permit them to make that assumption apparent to the public.

COMMISSIONER WALLS: I think there might be a looseness by either form of government, and particularly by the provincial government, because I think the consumer has fixed in his mind that retail taxes are a provincial tax. I am wondering whether the provinces should feel this is a tax reserve that they have obtained through use and it will not be impinged upon by the federal government and, therefore, they will not attempt to cooperate. The reason we are concerned with this is that so many of the recommendations regarding retail sales tax are only based on providing you get this cooperation; and the big problem is, if we do not get this cooperation what do we do.

THE CHAIRMAN: And is it worth our writing in the report: "It is a good idea, providing there is cooperation." -- full stop? I would not have thought so. I would have thought, in

reporting it we would have in our mind where cooperation is not obtainable and whether we are reaching for the moon; and I suppose that perhaps we should consider alternatives.

MR. FORD: I would have thought it was obtainable, speaking objectively, with certain stipulations as to what the provincial rights are in the tax would be.   , many of the provinces might be anxious to cooperate if by so doing they could standardize their exemptions with other provinces, and by so doing reduce their exemptions over all. If a tax on services were instituted at the same time, this could almost exclusively be blamed on the federal government. Simalarly, with cooperation the provincial governments are going to have to give, in any event because of collection problems between them on inter-provincial sales, this would be a powerful incentive for the provinces to enter a scheme which would provide for the collection of taxes on all sales and also on imports. It is a very difficult problem for the provinces at the present time.

COMMISSIONER WALLS: This matter of inter-provincial sales, it is a problem which exists today, and you would have thought that if you envisage all this cooperation that, perhaps, in their joint meetings with the other interested parties it would have already solved that.

COMMISSIONER GRANT: It is under discussions.

-13

COMMISSIONER WALLS: Yes, I know it is.

COMMISSIONER GRANT: Before leaving this point might I ask the representatives here this morning if they have given any thought, or if they have expressed themselves on another psychological factor involved in placing the tax at the retail level arising out of the fact there seems to be a proponderance of evidence that the housewife today -- and that is where the purchasing power of the nation rests, with her, in this field, certainly -- would be surprised in many instances to know that there is such a thing as manufacturer's sales tax on the goods that she is buying? This would suddenly loom up before her if it were at the retail level, and she would be confronted, perhaps for the first time, with the knowledge that here was a tax she had never known to exist and she had never paid, as far as she had knowledge before.

MR. LITTLE: Mr. Grant, I would think perhaps this is a good thing. I certainly do not share the concern of those who oppose the retail tax when they suggest this will have a retarding effect on spending. I just do not believe i+ for one moment. People are going to spend their money. If it induces some people to save modestly, this may be a good thing. But I cannot accept the proposition that disclosure of this tax will in the long run have any significant effect on the amount of money they spend.

COMMISSIONER GRANT: I agree, but the

-14

impact is in the fact that a government is now imposing a tax which is going to be disclosed, whereas they are receiving a vast amount of revenue now from a tax which is not disclosed. It is the effect -- and to get down to brass tacks it is the political effect that exposing taxes at retail levels will have. It is just a case of getting your reaction to that, as the group.

MR. LITTLE: I think our reaction to that is as we have expressed in our earlier appearance, when we talk about taxation in general terms, in the way of broadening the base. We think the majority of people should be aware of what it costs to run the country, and more particularly what their own demands upon government, for more help and support and social services, do cost. We think this would be a very good thing. If it slows up the expansion of spending by the government, maybe this may be a good thing too.

THE CHAIRMAN: On balance, you believe that in the national interest these taxes should be brought as much to light as it is possible to do?

MR. LITTLE: I think it is the condition we took throughout our deliberations.

COMMISSIONER GRANT: While the initial impact might be quite adverse and serious, both from the point of view of the individual recipient and also from the fact the sales might be curtailed or shrink as a result, you think that after that initial impact was over things would adjust themselves?

H-15

MR. LITTLE: I do. I think, in a small way, this was demonstrated by the provincial retail tax. There was a slow-up for a very short period, and things have now gone on as before. Certainly, the retail volume this Christmas in Ontario, as I understand it from someone in the trade, was at its highest level for a great many years.

MR. THOMAS: And the impact of the tax to raise the same amount of revenue means the housewife is still paying the same price for her can of beans.

COMMISSIONER GRANT: I do not know whether the Ontario government calls it sales tax or not, but in Nova Scotia we call it hospital tax, and there is a good deal of psychology there. Because they feel they are getting direct benefits from it. A person in hospital is not charged anything, and when they come out it does not cost them a cent, and they realize they are paying for it in the form of a tax, but it is called a hospital tax.

MR. LITTLE: In Ontario, when it was introduced, I think there was a good deal of pressure from politicians, in particular, on the government that our tax should be called an education tax.

THE CHAIRMAN: We will stand over until 2:20.

MR. LITTLE: Mr. Chairman, might I just apologize for my forthcoming withdrawal. I thought we might be through a little earlier, and I have a meeting with the Minister at 2:30, so Mr. Townsend

H-16

will act as Chairman from here on, and I am sorry I will not be with you until the end.

THE CHAIRMAN: We are glad to have had you before us up to now.

--- Luncheon adjournment.

--- Hearing resumed at 2.30 p.m.

THE CHAIRMAN: We are now at page number 98 and we were talking about the possibility of the provinces being agreeable to cooperate with federal government in sales tax, and I think we moved on from there. Mr. Walls tells me he has some questions on that.

COMMISSIONER WALLS: The only thing that struck me about it was, first of all, that the participants have given quite a bit of consideration to value added tax. Is the principal reason you are against the value added tax because it is administratively cumbersome?

MR. FORD: Yes, that is the principal objection to it.

THE CHAIRMAN: You have looked at it much harder than most people who have come before us. We have heard a good deal about the value added tax and we have read a certain amount on it, and I do not know that we want to probe into it too much at the present time. It has been looked at, as you know, in most European countries and it is being looked at very hard in the United Kingdom at the present time.

The next thing that really intrigued me was exemptions. I was wondering about the extent to which it might be possible to reduce exemptions without the tax becoming regressive or unreasonably regressive. You point out "... including farm and fishing equipment and supplies,

foodstuffs, products of mines and quarries, electricity, fuel and gas for lighting and heating, processing materials and certain printing and educational supplies." I suppose the reason for farming and fishing equipment, other than there being a lot of farmers and fishermen, is that it puts the tax on foodstuffs.

MR. FORD: Farmers and fishermen, for the purposes of the Excise Tax Act are regarded as manufacturers, and most of these goods could well be considered as producer's goods.

COMMISSIONER WALLS: The only thing is that the other producer's goods have now all been put on the taxable list, so I presume the first reason that farmers may officially continue is that it would indirectly create a tax on food which is contrary to the government's philosophy of advising regression.

THE CHAIRMAN: Products of mines and quarries -- is it true that they are all exempt?

MR. FORD: Yes.

THE CHAIRMAN: Yes, I think that is right. Of course, when it gets to the point where it is put into some product, it may become taxable after that.

MR. FORD: It may become taxable after that, or when one of the substantial users of the products of quarries is in the building trade for building materials, and this becomes the only form of building material which is not now taxable.

COMMISSIONER WALLS: Premixed cement -- when you buy a sack of premixed cement there is a tax. There is no tax on the gravel and there is no tax on the sand; there is tax on the cement, and when they are combined into sacks of premixed cement it is taxable.

MR. FORD: This is true although-mixed cement sold in dry bags is the only concrete taxable as such.

THE CHAIRMAN: What goes direct from the mine or the quarry to the consumer? I suppose coal does in the same form?

MR. FORD: Gravel and sand.

THE CHAIRMAN: None of those is taxable?

MR. FORD: No.

COMMISSIONER WALLS: To avoid regression, are there any alternatives you have thought of? Are there any other methods of avoiding exemption than by regression under the tax?

MR. FORD: Regression could be avoided by subsidizing all persons equally up to the amount of tax involved in those goods which are the minimum necessities of life. I am not suggesting this, but it is possible, for example, to adjust the family allowances and the old age pension, for example, as methods of avoiding regressivity in obvious cases.

COMMISSIONER WALLS: If you were to use another medium, would you then eliminate all

exemptions for simplicity of administration, or would you still allow what is called basic necessities?

MR. FORD: I think there are two choices here. One is to tax all consumer goods and make provision for basic necessities through grants and allowances. However, I think even if this was done you would still want to exempt producers goods to avoid a compounding of the tax.

THE CHAIRMAN: Do you know anything about the situation in three or four U.S. states which, I believe, make some such payment of that kind rather than exempting goods from sales tax? Have you heard of it?

MR. FORD: No, I am not aware of what is done in the States, although I understand there are some states that make payments. There are also some countries that issue stamps, I believe -- exemption stamps -- as a method of overcoming regressivity in sales tax.

COMMISSIONER WALLS: My next question was in regard to electricity. As most electricity today is predominantly a provincially owned utility, have you any reason to believe that they should collect a federal tax?

MR. FORD: It seems to me that a provincially owned institution or organization, if it was producing goods, would be required to pay the tax or collect the tax.

COMMISSIONER WALLS: Does that not mean, then, that we have to review the whole situation of governments paying taxes to one another? It would

not just fall on this, it would fall on corporation tax. You would have to look at the whole concept.

THE CHAIRMAN: This would not be taxed; it would be collected for the other government. I think that is all you meant, but I am not sure.

MR. FORD: Yes. Of course, under the present manufacturers' sales tax a tax on electricity when owned by a provincial government would be a tax on the provincial government since it is the manufacturer who is liable to pay the tax.

THE CHAIRMAN: You conclude here:

> "We believe that the present exemptions from sales tax should be carefully reviewed and the justification for each exemption examined in the light of the economic need for the exemption."

I would have thought the need could not be settled on the basis of economics alone; it would need to be on the social basis also.

MR. FORD: I suspect that was a confusion in terms as between social and economic.

COMMISSIONER WALLS: You are opposed to too many exemptions. You also say you wish to avoid double taxation -- page 103. In view of these two statements, would you be prepared to recommend that machinery and equipment used in production should be exempt from retail sales tax?

MR. FORD: This is something which I think the Committee itself did not go into in any great detail. I personally believe that producers' goods should be exempt from tax in all cases. However, this is my personal belief rather than a Committee belief.

COMMISSIONER WALLS: You also bring out the point when you continue your paragraph about competing in export markets. Of course, we are faced with the fact that we would lose $140 million of our revenue if we carried out that as an exemption, and there is great doubt as to whether it affects your export market, or not.

We had a large manufacturing organization before us which does considerable export business who said the other day that they believed it would not affect them. And there are three European governments who are all large exporting governments who all tax them.

MR. FORD: I think it depends a great deal upon the particular industry of which you are speaking. I have seen examples of industries where the impact of the tax on machinery and apparatus is very great indeed, where the costs of machinery and apparatus in the form of expendable tools represent up to about 20 per cent of the selling price of the produced article. In those cases, a tax at 11 per cent must inevitably raise the price at something over 2 per cent if the same profit margin is to be maintained. This is an

isolated case. It depends very much upon the particular industry of which you speak.

THE CHAIRMAN: A 20 per cent relationship of tools or equipment to sales would be abnormally high, would it not?

MR. FORD: Again it depends upon the industry. I would say that is very high, but I would suggest this is probably not unusual in the forging industry where the die wears out rather quickly.

THE CHAIRMAN: Then, on page 104, you recommend that this be spread to services, but you only recommend that if it goes to the retail level; is that correct?

MR. FORD: That is correct.

THE CHAIRMAN: You believe that if it were attempted at other than the retail level, it would raise such abnormal problems that it would not be a good thing to do. You do say that one of the problems is that of the rate. I find that most countries which tax services tax them at a lower rate. If one were to propose a tax on services, it would not be 11 per cent, it would seem to me.

MR. FORD: I think the point we were trying to make here was that we favoured a tax on services provided that the manufacturers' tax was moved to the retail level. If that is done, then we can see no reason for any differentiation in the rate between the tax on services and a tax

on goods.

COMMISSIONER WALLS: But I do not quite get your reasoning. I do not understand why you say that if you stayed with the manufacturer's tax the services could not be taxed at the retail level because in effect that is what you have in France today. While value added tax is in effect a distributor's tax, that is at least at two levels, whereas the tax on services at one level is really retail. So I just cannot see why, if it is necessary to raise more revenue and it is not found possible to move your commodity tax to the retail level, why you still could not put a tax on services.

MR. FORD: There are two reasons. The first is what we see as an administrative difficulty in splitting the charge made by a vendor for goods as opposed to a charge made for services. This is already a difficult problem under the manufacturer's tax where goods are sold on an installed basis. That is just one example of the service element which is not taxed.

Aside from the problem which you face there -- and this problem is magnified having a split rate as between the service element and the rate attaching to goods -- we also feel that the provincial governments would have every reason to complain bitterly if the federal government was levying a tax on services which would be apparent to the consumers at the same time as the provincial governments were almost undoubtedly considering moving

into the services field themselves. I think this is the next logical step for the provinces to take.

If we assume that a federal tax on services would be at 8 per cent -- and this is the frequently quoted rate for a retail sales tax to correspond to the 11 per cent manufacturer's tax -- and the provinces were also levying taxes on services at rates between 3 and 6 per cent, you would then have a tax on services evident to the consumer of between 11 and 14 per cent, and I think this would be unfortunate.

COMMISSIONER WALLS: You realize that you are going to have this problem of split level no matter what you do with a services tax?

Take for instance the two most commonly taxed services in other countries, the barber shops and beauty parlours, and the laundries and dry cleaning establishments. If you tax the barber he will have to have some exemption from the laundry for the towels he uses. So you cannot get away even on services without the necessity of split level taxing. You either have to decide that you are going to tax it at more than one level, or you are back again with forms of exemption based on licence.

MR. FORD: It seems to me whether you split the level or not you still have the problem as between the barber shop and the laundry because the barber's shop is inevitably going to use laundry services and it really does not matter whether you are

taxing at 4 per cent or 20 per cent, there is an element of double taxation unless the barber shop gets exemption.

What the Committee is suggesting here is that if a service tax is put on, then serious consideration will have to be given to the question of duplication and of compounding the tax, and services will also have to fall into that category of being producer's goods.

COMMISSIONER WALLS: Then you state that the tax should not apply to financial matters, such as interest. Yet the country that has perhaps used the tax on services the most -- France -- does tax financial institutions, but does not tax professional services; whereas Western Germany does not tax financial institutions but does tax professional services. What should be the line of demarcation as to what constitutes services under service tax? Should it be based entirely on the amount of revenue you want to raise, or should there be economic values as to why you should hand pick the services?

MR. FORD: Our conclusion was that the basis for hand picking services was administrative rather than economic or revenue. It was simply the point that if you hand pick those services which it is relatively easier to tax, then this is perhaps the most satisfactory way of imposing a tax because there are many types of service enterprises that it may be very difficult to tax simply because one cannot find them. The daily maid is an example of

the type of service upon which it is almost impossible to levy a tax.

THE CHAIRMAN: Would you tax professional services?

MR. FORD: I think the view of the committee was we would tax professional services.

THE CHAIRMAN: "Would" or "would not"?

MR. FORD: "Would". That is, provided they were not producer goods type of services. In other words, services rendered to industry which, in turn, were producing services or goods for sale would not be taxed; but where the services were provided for end consumers, it would apply.

THE CHAIRMAN: Some countries exempt them all, because in most cases they go to the distributor.

MR. FORD: This would be true in the case of accountants, but I am not sure about in all other cases.

COMMISSIONER WALLS: If you tax freight services you would be adding to the cost of our exports reaching seaboard, which would place us at a disadvantage in obtaining overseas markets.

MR. FORD: Not necessarily, because again you can provide for exemption of taxation on goods which in themselves are taxable.

THE CHAIRMAN: And you exempt, then, power going to industry, do you?

MR. FORD: Yes.

COMMISSIONER PERRY: I think you very quickly see this is simply an adoption of the

licensing system now used by the manufacturers' sales tax.

MR. FORD: That is correct; or by the provincial sales taxes, which have essentially the same system.

COMMISSIONER PERRY: I find it a little confusing to see just what weight you attach to the expression "consumer". I think you are thinking of the ultimate beneficiary of the process of production, because in law a producer who buys goods to be used by himself is the consumer. But it is not that process of consumption that you have in mind; it is way out at the end of the line?

MR. FORD: It is consumption by individuals.

COMMISSIONER PERRY: Well, there are individuals in business.

MR. FORD: Other than for business purposes.

COMMISSIONER WALLS: Do you mean, if a factory buys office equipment for their office, you would not tax that? If they bought typewriters, and so on, they would be the eventual consumer.

MR. FORD: I see very little difference to the manufacturer of the costs incurred for office equipment or production machinery. The same costs get built into the price structure, and become just as much part of the price of the goods.

COMMISSIONER WALLS: You are already searching for $140 million to look after the goods

and apparatus used in production. We have always taxed the trucks and the office furniture and office equipment. If you take it off office equipment, you would have to treat trucks used by the firm much the same?

MR. FORD: Yes.

COMMISSIONER WALLS: Then we are really getting into a big tax deficit, and we are surely going to have to go after the professional services.

THE CHAIRMAN: Just put the rates up.

COMMISSIONER PERRY: You could argue for thorough consistency in the base, with a rate producing the necessary amount of revenue.

MR. FORD: That is correct. Presumably, if not in the short term, then at least in the long term the price to the consumer would not increase, even with the higher rate.

COMMISSIONER WALLS: But you would have them facing a 20 or 30 per cent visual retail tax?

MR. FORD: This is what we are now facing.

COMMISSIONER WALLS: Indirect and hidden?

MR. FORD: Yes.

COMMISSIONER WALLS: You are quite right.

COMMISSIONER PERRY: What is a little

more frightening is the statement -- I do not know whether it is a statement, but an implication some witnesses have left that it may be some time before the manufacturers' sales tax would get worked out of the system in prices, and this would not be a matter of working off old inventory, but the matter of a rigidity of prices. It would take competitive forces gradually to squeeze the old sales tax out of the system, in the meantime a new sales tax having come on at the end.

MR. FORD: There may be a considerable amount of price rigidity in the retail field in some lines of goods. I suspect this is not there in all lines of consumer goods.

THE CHAIRMAN: In the manufacturers' areas.

COMMISSIONER PERRY: I was thinking mainly of prices manufacturers charge where the sales tax is now buried in the price and is usually unknown to the wholesaler or purchaser. But even in this situation there would be a resistance to simply dropping the price by the amount of the former tax.

MR. FORD: Of course, at present corporate rates, the government would pick up 50 per cent of any figure.

THE CHAIRMAN: This means that 50 per cent of the old sales tax remains built in.

COMMISSIONER WALLS: Which corporation tax are you talking about?

MR. FORD: The corporation income tax.

COMMISSIONER WALLS: Did not you earlier in your brief recommend it be reduced?

MR. FORD: Yes, to 40 per cent, so I will revise it to 40 per cent.

THE CHAIRMAN: I would like to ask a question about pyramiding. Do you believe there is a substantial amount of pyramiding of taxation -- and I define it as meaning profits made on tax.

MR. FORD: Are you looking at the top of page 107?

THE CHAIRMAN: Yes.

MR. FORD: In reading this portion of the brief a few days ago I realized that was the wrong word. The word should be "duplication" or "compounding".

THE CHAIRMAN: Oh, thank you. You do not refer to what is generally discussed under the heading of "pyramiding" in this, do you?

MR. FORD: We may have made a passing reference to it.

THE CHAIRMAN: I will wait until we come to it.

MR. FORD: I cannot remember for sure whether we did make reference to "pyramiding". I think the view of the committee is that pyramiding may be a problem in the short run, but in the long run competitive forces will eliminate any excess profits made on sales tax. There is, of course, an element of pyramiding in the financial cost of maintaining an inventory. It covers the interest

costs and insurance costs and inventory losses, so there must be pyramiding to the extent that sales tax is included in the inventories.

THE CHAIRMAN: That is further taxation, really. To the extent there is tax included in the inventory, the government has got money for the goods that pass through the system to the consumer. To that extent interest is borne and must be passed on, so the goods sell at a higher price.

Yes, Mr. Walls?

COMMISSIONER WALLS: I was on to where they are dealing with the need for appeal, on page 110, so I will wait until you reach that.

THE CHAIRMAN: At the top of page 108 you point out what we have already discussed, namely that the tax at the manufacturer's level makes it rather difficult to tax services. It seems to me while this applies in a general way it would not apply to telephones, or hydro electric power, that one could easily impose a tax on those things, and manufacturers' sales tax at the same time -- is that not so?

MR. FORD: Yes, this could be done, though once again the question arises, since telephone charges, other than long distance charges, are now under provincial sales taxation already, whether the provinces would not have some objection to a charge being made on those particular items. Again, a tax on electricity at the manufacturer's

level would, in fact, be a tax on a provincial agency, in most provinces.

COMMISSIONER WALLS: In British Columbia we have provincial sales tax on electricity too.

MR. FORD: This, of course, is the provincial government taxing the consumer, where the manufacturer's sales tax is not on the consumer.

COMMISSIONER WALLS: You are quite right.

THE CHAIRMAN: On page 109 you mention this matter of agreements, and I think it is correct, that the Sales Tax Committee recommended agreements be entered into with the trades as to discount. That is exactly what they are called in the U.K., and exactly what they are. As far as I recall, they are entered into for a period of time. I forget what the period is -- possibly one or two years, certainly not for very long. It seems to me it works very well in the United Kingdom because once they had negotiated the agreement, which they did with the representatives of the particular trade, that was the end of it for that period of time; and if anyone wanted to complain he had to wait until the current agreement elapsed or expired. Their experience was good, as far as I recall. Do you know anything about that?

MR. FORD: We have not studied the question of agreements as they related to other countries. I think if an agreement were made for

a comparatively short time this would overcome any objection we have heard -- say, for a period of a year or two.

THE CHAIRMAN: I am almost certain that is the case in the United Kingdom.

MR. FORD: I think if a system of agreements were entered into it might be necessary to provide, in the absence of an agreement being reached, that all members of the industry would have to be taxed solely on the sale price in order to force industries to negotiate. Otherwise, there would be no reason to sign the agreement. Once you arrived at a satisfactory base you would quietly go on using it the first time as it suited you, and the agreement would not ever be signed.

THE CHAIRMAN: If the law were drawn that way, it would encourage people to enter into agreements.

COMMISSIONER WALLS: I am on page 109. We get quite a number of people wanting to get away from ministerial decision in regard to notional wholesale values. But if you are going to make the courts the last recourse, which so many people ask for, is not it going to be necessary then that you must define by statute the formula, or must make provision by statute providing regulations whereby the formula can be arrived at before you have anything you can appeal to before a court? And if you are going to do that, are not you going to get into too great rigidity?

Some other countries have only a tax appeal board as the authority, without the authority of the courts. I would like to know what you would think of continuing to allow the Minister a certain amount of decision and discretion, and having an independent body, such as the Tax Appeal Board, as the final means of appealing these decisions.

MR. FORD: Well, I think in paragraph 318, on page 110, we consider the suggestion, that a set of formalized rules be made up to the procedures to be followed by the Minister, and which the Tax Appeal authorities would follow in arriving at a price. We adjusted that on the simple ground of rigidity and of the difficulty in deriving formulae that would satisfy all types of taxpayers.

I think, in any case, that where notional values are going to be used it is essential there be a certain amount of ministerial discretion. The thought at the moment is simply that once the Minister has actually decided his discretion, there can be no appeal, even though it may have been exercised in a most unreasonable way, simply because there is no provision for a per cent less than sale price.

THE CHAIRMAN: There is always some element of ministerial discretion in anything that he does, because he has to take the initiative. Whether or not it is in the law, he has to exercise

his discretion. Then, if he does not, or is challenged, it goes to law. It is just a question as to how strong you want to make that discretion.

I would interpret Mr. Walls' question: Do you wish to write into the law, "at the Minister's discretion", because if you do that is all there is to it, and it stops there, and he is the final "court".

MR. FORD: I think our view would be, if I can turn for a moment to the Income Tax Act, Section 85 (b), which allows a reasonable reserve in respect of a portion of the profits this is something determined, in the first place, by the Minister, but it is subject to court review. What we are really suggesting is that the Excise Tax Act and its valuation provisions should provide for a price reasonably to be regarded as equivalent to the price the taxpayer would sell the products to the wholesaler.

THE CHAIRMAN: Is not that what the Tax Commission set out? It is drawn in very broad language, I remember, but it again left the initial job to the Minister.

MR. FORD: Yes, that is true.

THE CHAIRMAN: Of course, there was an opportunity for the courts to alter what he had done.

COMMISSIONER WALLS: It is rather interesting to note that in two countries where the final authority is the Tax Appeal Board that people

are very rarely using it since it has been put into effect. Your suggestion seems to be they have it there, and in neither case is it being used to any great extent. I am referring to both the U.K. and Australia.

MR. FORD: I can only say, from my own professional experience, I know of only a few cases where there would have been a question referred to the courts. I think one of the outstanding points of the sales tax administration in this country is that it has been done on the most equitable basis imaginable, and there are very few cases, but there are a few, and this is a protection against an unfavourable decision of the Tax Appeal case.

COMMISSIONER WALLS: On the next page you deal then with the liability of the vendor in regard to somebody issuing an incorrect exemption form. The trouble seems to be, as things are today, that under Section 68, while it makes the vendor responsible, it does not give him very much power within the Act to exert it. What do you think of the idea that is used in one other country, where the exemption is not made out to the vendor, but it is made out to the Crown, and therefore if there are any cases like that the Crown has the responsibility of prosecution?

MR. FORD: That certainly would be an acceptable method. An alternative method would be to insist that all persons entitled to claim

an additional exemption would be required to be licensed and to quote their licence on every order for goods conditionally exempt, and then be held responsible for the use of that licence to the Crown. I think probably I am saying the same thing as you, but in different words.

COMMISSIONER WALLS: I was rather wondering why in your brief on sales tax you made no reference to what we were to do with excise tax, because excise tax accounts for $250 million coming in, and there is an additional 10 per cent on some items, and on others an additional 15 per cent. Irrespective of what level we decided to tax, there have been recommendations we should follow the rate being given by other countries, by having a multiple rate sales tax. In other words, instead of having two taxes, call it a sales tax, and on those items where you have 10 per cent on excise tax you would now have over 21 per cent at a manufacturer's level, or perhaps in the neighbourhood of 16 per cent at the retail level.

MR. FORD: I see no difference when you are talking of taxes at the manufacturer's level as between goods subject to excise tax as opposed to the sales tax. In other words, if it was desired to combine the rates, so long as you are combining the rate at the manufacturer's level, I see no difference.

If the tax were raised to the retail level -- I am afraid this is a point which we intended to cover in the brief and somewhere in the editing process it got left out. We intended to recommend that excise tax remain at the manufacturer's level. Only the general sales tax would be moved to the retail level.

COMMISSIONER WALLS: Why would you impose that, for instance, on Mr. Eddy, let us say, who manufactures matches? If you are going to charge him 11 per cent at one stage and then another 10 per cent at a different stage, why should it not just be one tax collection?

MR. FORD: I think our reasons for this were that while the manufacturers of goods subject to excise tax -- there are relatively few manufacturers involved, only a very few industries and they are well aware of those items which are subject to excise tax and those which are not. If these were combined at the retail level it would mean setting different rates for different products and for administrative reasons we felt it was best to leave it at the manufacturers level.

COMMISSIONER WALLS: Well, if you are going to maintain a two-tax system or a combined tax depending on which level is used, what would you consider to be the criterion of products that you carry more taxes than others. We have had representations that this is not a luxury tax but in fact nobody seems to be able to define just what constitutes the authority for certain products to be carrying more tax than others. Would you care to give us a definition of what products should be taxed more than others.

MR. FORD: I am afraid the Committee really did not get into the question as to whether certain items should be taxed more heavily than others and I think we would be better not to make any specific recommendation as to one product or another.

THE CHAIRMAN: There is only one more point. You mention here, I think, that you are in favour of publication of all rulings and I think most people who have appeared before us say pretty much the same thing.

That completes our questions, I think. It just remains to thank you very much indeed for the great deal of research you have put into this and the hard work you have given to it to accomplish this very worthwhile task on the Excise Tax Act. It is something that worries us a good deal, I might say, and we need a lot of help. We are very grateful to you for all the help you have given us. Thank you very much indeed.

MR. TOWNSEND: I, in turn, would like to thank the Commission on behalf of the Canadian Institute of Chartered Accountants and Mr. Little and his Committee for having the opportunity to appear before you.

I think if our brief and answers to your questions are of any help to you at all then we will be well satisfied. I should also like to say, Mr. Chairman, that the Institute will of course be very happy to give you any other assistance it can as you get along in your deliberations. If there is any information we can give you or any help we can give you at all, we will be happy so to do.

THE CHAIRMAN: That is indeed kind. Thank you again.

Is there any further business, Mr. Secretary.

THE SECRETARY: One more item of business, Mr. Chairman. This was just delivered to me within the last ten minutes by registered air mail a brief from Mr. R. S. Ball of R.S. Ball and Company, Chartered Accountants, Winnipeg. Mr. Ball wishes me to enter this brief into the record which I will now do as Exhibit 344.

---EXHIBIT 344: Brief from Mr. R.S. Ball, Winnipeg.

THE CHAIRMAN: Thank you. We will stand over until 9:30 tomorrow morning.

---Whereupon the hearing adjourned.

ROYAL COMMISSION

ON

TAXATION

HEARINGS

HELD AT

OTT[illegible]

ONT.

VOLUME No.: DATE:

98

OFFICIAL REPORTERS
ANGUS, STONEHOUSE & CO. LTD.
BOARD OF TRADE BLDG.
11 ADELAIDE ST. W.
TORONTO

364-5865 364-7383

ROYAL COMMISSION ON TAXATION

Proceedings of hearings held before the Royal Commission on Taxation in the Supreme Court of Canada Building, Ottawa, Ontario, commencing at 9.30 a.m. on Friday, January 24, 1964.

COMMISSION:

Mr. KENNETH LeM. CARTER -- Chairman

Mr. J. HARVEY PERRY

Mr. A. EMILE BEAUVAIS

Mr. DONALD G. GRANT

MRS. S. M. MILNE

Mr. CHARLES E. S. WALLS

LEGAL ADVISER:

MR. J. L. STEWART, Q.C.

RESEARCH DIRECTOR:

PROF. D. G. HARTLE

SECRETARY:

MR. G. L. BENNETT

ADMINISTRATIVE OFFICER

MR. A. J. SIM

INDEX TO EXHIBITS

NO.	DESCRIPTION	PAGE
345	Statement by the Canadian Tax Foundation to the Royal Commission on Taxation.	9175
346	Submission of C. W. Saddington entitled "Capitalism -- Individual, Corporate or State in Canada".	9256

* * * * *

THE CHAIRMAN: Mr. Secretary, you may commence.

THE SECRETARY: On this, the last day of the public hearings, we have a submission from the Canadian Tax Foundation. Mr. Russell, the Chairman of the Canadian Tax Foundation, is here together with Mr. Ron Robertson, Director, and Mrs. Gwyneth McGregor, Editor, to present the brief.

I would like to enter this submission into the record as Exhibit 345.

--- EXHIBIT NO. 345: Statement by the Canadian Tax Foundation to the Royal Commission on Taxation.

THE CHAIRMAN: Good morning Mr. Russell, Mr. Robertson, Mrs. McGregor; it is nice of you to come back to see us again. I recall that we asked you when you were here before if you would be so kind to do just this, and we suggested it would be fitting if you did it at the end. I really think you have taken up the suggestion magnificently, and what you have put in in the way of a brief -- which I do not think is the right word for it, really; it is a pretty full piece of writing -- is going to help us tremendously in the days to come. It seems to me that there will be many times when it may go a long way to preserve our sanity as we try to come down on precise rules.

When we are considering this of course we will recognize that you have said to us that many of these decisions have been a result of a happy compromise in some ways. I am very pleased indeed with what you have done.

The appendices at the back, to my way of thinking, are a most erudite piece of writing on taxation. This whole question of progression in personal tax rates is an extremely difficult one. While I do not think you have offered us a complete solution, you certainly have taken us a good way down the alley. Thank you very much indeed, Mr. Robertson, Mr. Russell.

Mr. Russell, do you have something to say to us?

MR. RUSSELL: Just very briefly I would like to express our appreciation and the honour we feel that you have asked us to come to see you again; this is semi-graduation day and we might refer to our appearances as the alpha and omega of your Commission. The Foundation itself does appreciate this.

As you point out, sir, this submission does not pretend to summarize the 363 submissions you have received, nor does it reflect any position of the Canadian Tax Foundation or its members, which would be an impossibility. It is rather an attempt on behalf of the staff of the Foundation, who have been following the hearings, to help sort out some of the main threads and issues which the Commission

itself will have to decide upon.

The two appendices to which you have referred and which are referred to in the statement itself we submit for analysis by your Commission and your staff. The essay on progressive taxation was written by Mrs. McGregor, and we thank you for the tribute in the point you made. Mrs. Bryden wrote the Appendix A to the personal income tax section, and we trust that will also be useful to you.

We have taken the liberty of pointing out in the summary some of the deliberations the Commission may want to keep in mind.

We would like to present to the Commission the first copies of the Report of the Vancouver Conference last November which, by prodigious efforts on behalf of our staff, have been brought out before the end of January.

THE CHAIRMAN: I thank you because I think that was done partly on our account.

MR. RUSSELL: We hope this will also be of some use to you, sir. Copies will be in the mail to all members next week. These are half a dozen advance copies which we were able to obtain.

With those few remarks, sir, we would be happy to place ourselves in your hands. I am just here to hold Mr. Robertson's hand, so to speak, because, as you will appreciate, this is largely a staff effort by the Foundation, and while I do not disassociate myself from it, I do not

pretend to be able to answer the numerous questions I am sure you would like to ask.

THE CHAIRMAN: Mr. Russell, am I not correct in saying that this is one of the very few occasions, if not the only occasion, on which the Foundation has put forward a submission to a public body of this kind?

MR. RUSSELL: I think the two appearances before you, sir, are in fact the only times.

I do not think this is a brief in the form in which you have been receiving briefs. We are not advocating anything. The staff have merely endeavoured to point out the highlights in order to assist and perhaps direct your thinking. We are not recommending anything nor are we against anything in particular; we are rather pointing up, as we did in our first brief, the main factors which will have to be considered and decided by your Commission.

THE CHAIRMAN: It has been the policy of the Foundation in the past not to take a position in contentious areas, and I think you are continuing that policy. I think it has also been the policy of the Foundation to do research work, to assist others. I think in this case you have, to some extent, made an exception because of the Foundation's interest, and because of the importance of this matter, and you have come forward on your own initiative.

MR. RUSSELL: And, of course, to take a unanimous decision from 2,000 accountants and 2,000 lawyers is an impossibility.

THE CHAIRMAN: We continue to be very grateful that you should make such an exception in this case.

COMMISSIONER PERRY: While I do not wish to reduce the importance of this Commission, I think the Foundation did make a presentation to the Gordon Commission.

MR. ROBERTSON: Mr. Perry can speak with more authority on that than perhaps we can.

THE CHAIRMAN: Now we come to the submission itself and I would ask the Commissioners if they have any questions they would like to put to you.

To begin with, you make reference to a proper balance which, you say, has to be achieved and maintained between flexibility and certainty. I agree that this is a most important question. But then you go on to indicate that an advanced ruling system might be one way of improving this balance. I do not think this means for one second that you suggest it is the way to improve the balance; you say it may be one way of improving the balance.

Why would you think that an advance ruling (which I think in itself can only be an assessment made in advance of the event rather than after the event) may be more flexible? I think all one could say about this is that it gives the taxpayer

information as to what action the assessor is going to take. Is that not right?

MR. ROBERTSON: Yes, in that way it permits the taxpayer more flexibility at the right time.

I believe I see the Chairman's point -- he is no more flexible than he was before except he can find out in advance whether or not his move is correct.

THE CHAIRMAN: Yes, if the Minister comes down against the ruling -- and the Minister has discretion as spelled out in the Act -- I would have thought that was the end of it. If the Minister has only limited discretion, then it is a different matter; that provides a certain amount of flexibility.

MR. ROBERTSON: That is correct, but in some of the rather involved reorganizations, the threat of ministerial discretion after the fact is what is quite worrisome, whereas it would seem that the same effect, as far as protection of the revenue is concerned, could be achieved by having a decision made before the reorganization is completed, before everything is worked out.

THE CHAIRMAN: I think most people would agree that that would be a help in arranging a substantial transaction.

MR. ROBERTSON: Yes.

THE CHAIRMAN: We have heard that a good deal. We have also heard a certain amount about

the difficulties of doing just that. In the United Kingdom these advanced rulings are provided by law only in a very few instances -- I think two places in the Act.

The only reason I raise this is to see whether or not it does provide flexibility. I think I would concur, it certainly gives the opportunity to the taxpayer to be more flexible in his approach to whatever he is going to do; he has more choice.

MR. ROBERTSON: I think perhaps we also had in mind that certainty decided the equation as much as the flexibility, because I suppose with just a plain piece of law, just as it stands, the taxpayer is most flexible, and maybe to his own disadvantage at a later date.

COMMISSIONER PERRY: I was wondering if it would not be as equally important as having your basic law flexible. There is not much point really in having rulings on a law which in itself is out of date.

MR. ROBERTSON: I would think this is so. The rulings would presume a good basic law to begin with. It is a half way house proposition again.

MR. RUSSELL: I would think, Mr. Chairman, it would be possible to find a term that would mean the same as ministerial discretion. It might be helpful if we called it something else, if such a thing could be done. I know, speaking more personally, the briefs deposited by the professional

institutes -- both the Bar and the C.I.C.A. are very much against ministerial discretion. My experience over a number of years has been that the discretion in a vast number of cases has been to relieve the taxpayer in something which is obviously equitably in his favour, although the actual wording of the law might not provide that.

I think of the remarks of Mr. Justice Thorsen in Vancouver when he spoke about the letter of the law have been adhered to, but I say that when discretion has been exercised it has generally been to permit parliament to do something that is equitable in the taxpayers favour. If it has been exercised against the taxpayer, probably the taxpayer was entitled to have it so exercised because he cooked up some nefarious scheme. A safeguard would have to be built in to give appeal to the court possibly when discretion is exercised as envisaged in the recent amendments.

THE CHAIRMAN: Mr. Russell, if we are going to put it in the law and then we are going to take it away from the Minister by giving discretion to the courts, it seems to me the solution is not to call it something else; the solution is simply not to write into the law ministerial discretion whatsoever. The Minister within certain limits, it seems to me, in the first instance has always had discretion of interpretation.

MR. ROBERTSON: That is quite true.

THE CHAIRMAN: If you put in the word "reasonable", then it is up to the Minister to decide

what he considers would be reasonable, and that is exercising his discretion even though the discretion is not written in, because "reasonable" requires him to exercise discretion. If you want to challenge his discretion, then you go on to challenge it elsewhere. Why put it in? I do not see any purpose.

MR. ROBERTSON: It is raising red flags unnecessarily.

THE CHAIRMAN: I have an idea that I may have learned what I am saying from Mrs. McGregor in a paper of the Tax Foundation. Did you say something like that?

MRS. McGREGOR: Yes, I did. I felt the same result could have been achieved if the Minister had been left out altogether. You can literally take the words out of the section altogether. With the right that has been given, I think that is in fact the end result.

THE CHAIRMAN: The only purpose of the insertion of the words in the Act is to stop it going beyond the Minister, I would have thought. Is that not what you think?

MRS. McGREGOR: I think I would rather not guess what was the purpose for putting it in.

COMMISSIONER PERRY: It is important to define terms here, because in the sense of the jurisprudence the discretion is an arbitrary exercise of judgment from which there is no appeal to the court, and there are only two or three places in the

law where this sort of feature is seen.

I think what most people refer to when they speak of discretion is the right to make a judgment. The Minister must make judgments; he is making judgments a thousand times a day in all sorts of areas in the law, particularly where he is saying whether a thing is reasonable or not. In fact, having been on the committee that redrafted the law, I can quite clearly recall that one of the simple processes was to go through the 101 discretions, or whatever it was then, and simply substitute the rule of reason for ministerial discretion. This puts the thing in quite a different framework -- an invitation to the Minister to exercise a judgment which can be appealed in the courts. So I am not sure that we are always on all fours here when we are using the word discretion.

THE CHAIRMAN: We have very seldom heard, I think, anybody come before us saying this should rest on the ministerial discretion without the right of appeal. We have heard many people say ministerial discretion with the right of appeal, but when you are speaking about the use of ministerial discretion, I think you qualify it and say something about being able to go beyond the judgment of the Minister, do you not, Mr. Russell?

MR. RUSSELL: Yes, if the discretion is exercised in favour of the taxpayer he is not going to object.

THE CHAIRMAN: That does not require the names "ministerial discretion", to do that?

MR. RUSSELL: No.

COMMISSIONER PERRY: In the language of the jurisprudence you cannot speak of a discretion which can be appealed.

MR. RUSSELL: I do not really know what we have in the Act now. It is a real mixture, and it has the nasty words in it.

COMMISSIONER PERRY: Yes.

COMMISSIONER GRANT: If the discussion centres about the question as to whether or not there should be an appeal from a ministerial discretion, then, if that is the crux of the discussion at the moment -- Do I understand that to be so?

THE CHAIRMAN: No, you do not. We are discussing whether there should be something in the Act called "ministerial discretion"; and if it is so put into the Act, what it means. Whether it means there is an appeal -- which was not the case when it was in there before; and we do not think it is intended to be so now. If that is so, why put the words in the Act at all, if the Minister always has a discretion in the first instance. I think we have pretty well said that in his assessing practice he must exercise discretion, and then there

is an appeal from that.

COMMISSIONER GRANT: You could call it "discretion", or could not you call it also his ability to interpret the statute? He arrives at a conclusion that is based upon his interpretation, and I think there would not be the element of discretion there. Discretion arises only when the section of the Act states it is within the Minister's discretion -- spelled out in so many words.

THE CHAIRMAN: That is what we did not think. Perhaps you are right. We thought if he made an assessment, and in making the assessment he exercised a discretion, that is challengeable.

COMMISSIONER GRANT: I must question whether that is a discretion. He arrives at an opinion, but I do not think that is a discretion.

COMMISSIONER PERRY: I think most people feel when the Minister is exercising discretion he is being discreet; and this is what they want him to be.

THE CHAIRMAN: Moving on, I was intrigued with your description of the superman economist flying over a mountain range, and from that vantage point looking down at the tax administrators, lawyers, accountants, or corporation controllers being stuck and being unable to get through. I think there is a certain amount of truth to that, I must say.

MR. ROBERTSON: Mr. Chairman, this is perhaps another way of saying possibly something

the members of the Commission have noticed. Very often you find yourself using the same words but meaning different things, depending on whether you are a lawyer, or an accountant, or an economist. It is a little puzzling for a while, until each group tunes in on the others' special use of language. I think that in the past a little confusion has been caused by this; but we are gradually speaking a triple-tongue language here, and it is helpful that is occuring.

COMMISSIONER PERRY: You sometimes find the taxpayers have a fourth language.

MR. ROBERTSON: Yes, but it is unprintable very often.

COMMISSIONER WALLS: Let us say they put the phrase "gi'me" into the language.

THE CHAIRMAN: I am wondering if we should, at the bottom of page 5, take a look at this matter of growth. You say it appears that taxation is one of the keys. I must say, I have come to think of taxation as being nothing but a weight on taxpayers, and if it is to be used to promote growth, it is by lifting the weight off certain groups of taxpayers, and giving them a better opportunity to progress, because they have less weight on them than they would have if there had not been some adjustment made. I suppose that is all that one can find in the way of stimulating growth, is that right?

MR. ROBERTSON: I know of no other magic use of the tax system. I think we have all

looked at the beginning to see if there was some little thing you turned down in the tax system that made everything work and click together; but I know of no one who has pinned it down. I think the way you suggest is one way of looking at it.

THE CHAIRMAN: I find myself asking witnesses what would be the result of removing taxation from them. On the other side, any spending of money by the government may provide a real stimulus, that is outside of our job. We are only concerned with the sorting out of taxation, and the maximum we can ever recommend is the complete relief. You would feel the same way?

MR. ROBERTSON: Yes, I would think so. Your reference to the "weight", I think, is important, and can be carried just as you carry physical weight. You carry it in one position or one spot, and it perhaps causes a little less pain if you spread it across another part.

COMMISSIONER PERRY: I find it interesting to observe the sort of reaction witnesses have had to tax incentives which apply to only a limited segment of the taxpaying public. These have been pretty roundly condemned on the ground they are discriminatory. I must say, in my own thinking I almost define an incentive as being a discriminatory tax device, and simply lifting the whole burden does not really give you the sort of change in direction you wish to bring about in a specific area. So it would now seem that "incentive" has come to mean a

lifting of the whole tax burden, and not the use of taxation for rather restricted purposes. At least, this is what seems to have emerged from our evidence.

MR. ROBERTSON: Is it not a fairly widely held theory about tax incentives that if they apply to everybody they are no longer incentives? It is the discriminatory nature of them which seems to offer some chance of them working.

THE CHAIRMAN: I wonder if that is a fair statement. We heard it said yesterday, I believe, or perhaps the day before yesterday, that the capital cost allowance system has been more generous in rates of depreciation than what companies generally use for their own purposes, and to that extent we have found a very substantial difference between the two -- if one measures differences by the accumulation in taxes which would have been paid on the basis of depreciation, and the taxes which were paid on the basis of capital cost. The amount of that difference may be very, very substantial, in which event the government is actually short that much cash, and business is "in" that much cash. The cost difference of that is, of course, the interest on the money, but the cash flow is very substantial.

One witness said yesterday that he believed the Canadian competitive position had been greatly improved because of these substantial write-offs. Write-offs apply generally throughout the piece, and if this man is correct, that has been a

very effective stimulus.

MR. ROBERTSON: I imagine it applies across the piece, but it will still weigh particularly heavily for people able to use capital cost allowances to a greater extent than another type of business. That is where the arguments come together; they do agree with each other at that point. It is a general incentive, and yet as between the industry that obtains or uses a lot of capital for equipment, it is of greater advantage to that company than another. This may be the direction in which to go. It means the profitability of that type of resource being used. I do not see any particular conflict in the two lines at that point.

THE CHAIRMAN: I thought I noted a conflict in saying that an incentive, to have an impact, should be in a restricted area. I was trying to reply to that by saying we have been told that particular incentive -- which is, I think, an incentive -- has had a very significant effect -- or did I misunderstand your statement?

MR. ROBERTSON: No. That is one of the broader incentives, but the only one that I think can be put in that category ---

COMMISSIONER PERRY: It is a restricted incentive with very broad application.

MR. ROBERTSON: That is right. This still is discriminatory -- I think you could put it that way -- against firms who do not have the use of substantial capital assets.

THE CHAIRMAN: And in favour of those who do have substantial capital assets?

MR. ROBERTSON: Yes, but fortunately it has a very broad base, and I cannot think of any others that are that broad, and I think that is why capital cost allowance, or equivalent systems, are used frequently.

COMMISSIONER GRANT: And yet capital cost allowance is assigned to replace machinery, plant or equipment that is wearing out or becoming obsolete. The fact it does increase the cash flow puts the company in a position to do that very thing. To replace these machines that money is being spent and put into circulation immediately. Let us assume it is, if the plant is going to be kept up and it, in turn, is earning tax dollars through other media or other companies -- the suppliers of the machinery, the producers of the brick that goes into the plant, and so on. That money, while it is a large sum, and it looks like a large saving to the company, is actually designed to keep that company in production. The company that operates on a very limited capital, fixed capital, must be contributing considerably more in its earnings by way of taxes.

MR. RUSSELL: Is not there another side to this coin, that we are possibly very rapidly approaching where the companies reach the pass-over point, and they have reached to the position where they have used up the capital cost allowance for tax

purposes and are faced with providing extra cash to pay the tax.

THE CHAIRMAN: Some of that money may start going back to the government, but I am very surprised if it does, because there are new businesses starting all the time, and while some companies have crossed over, I think the average have not.

MR. RUSSELL: The hump is pushed forward all the time by additional capital expenditures, but some will go over, and they are starting going over now.

COMMISSIONER GRANT: Plus the fact the company itself must keep itself attuned to the times at all times, to remain competitive. Generally speaking, it must. It must keep its capital in absolutely top form, and today, with the computer in the electronic age, obsolescence is a factor. We have not had any submissions, I can recall, on the ground of increasing capital cost allowance in such fields as the electronic field.

THE CHAIRMAN: We have had I.B.M.

COMMISSIONER GRANT: I was not here that day. That is right, and I am glad that it is before us, because I think it is quite a factor.

THE CHAIRMAN: As a matter of fact, my point is capital cost allowance, as managers say, is necessary to keep plant adequately depreciated, and I would have thought managers are the best judges of that. Nobody, no witness has yet said to

me the managers are not the best judges.

MR. RUSSELL: I am quite sure, if we had no taxation at all, the depreciation claim would be substantially reduced from what it is now.

MR. ROBERTSON: One must watch what line you should draw, assuming this extra is what the manager claims is incentive. Theoretically, you could work it up to 100, not worrying about the revenue at the moment, except at that point you are going to write it off anyway, and it is going to be the loss of the interest factor. But you run into the problem of working in the wrong direction with the ups and downs of the country. I think Sweden experienced this with their free write-offs about which people were very enthusiastic in the boom period, and then it drops off and goes in the opposite way to what they want it to.

THE CHAIRMAN: In the case of Sweden, that was in 1958 and they were just too slow in getting it going, and by the time it was really going they were coming out of trouble.

COMMISSIONER PERRY: I think there are different things involved here.

MR. ROBERTSON: I am not referring to their reserve system.

THE CHAIRMAN: I am sorry, their 100 per cent write-off?

MR. ROBERTSON: Yes, the 100 per cent write-off, which works too well and adds to the ups and downs theoretically.

THE CHAIRMAN: As you say, it was encouraging people to take too much and reduce their taxes too much at the wrong time?

MR. ROBERTSON: Yes.

THE CHAIRMAN: We have had quite a bit of evidence in favour of research incentive. That seems to have come out best in the discussions, and that certainly is the selective one. I cannot remember very much being said against that. Would you care to discuss it?

MR. ROBERTSON: I think, first of all, one has to agree you have to look at the particular incentive. Scientific research is a little bit like motherhood, and one does not criticize it; but I think it is probably the closest type of particular incentive that has a general application. Probably right next to the capital cost allowance it has general application, and I think people realize the importance of scientific research to Canada, and will practically put up with the internal difficulties of it, because the objective seems so right for us at this time. I have no way of knowing but perhaps the Commission has, just how much this means. There seems no way of judging these things. This is one of the basic problems with them. In order to protect the revenue they have to be limited, and you turn around and find out it is a "Johnny-come-lately" type of proposition, and find the man who has put a lot of money into research does not get the benefit, and you say, "This is the very reason for the incentive. We want to bring these people in."

You are quickly into the discussion of what is fair, and I do not think there is any fast answer in relation to the specific incentives in scientific research, and I think they can stand up as well as any.

COMMISSIONER PERRY: You sometimes get the feeling people regard an incentive as a reward for good behavior rather than a "carrot" for those who are not coming up to standard.

MR. ROBERTSON: Yes, none of us seems to have in our mind just exactly how the incentives are supposed to work. Very often when you reason some of these through, you find, if you follow the path logically, you would pay no attention to the incentive. Perhaps it is supposed to take advantage of our emotional approach to things.

COMMISSIONER PERRY: Very strong exception is taken to the base for the scientific research expenditure, because this rules out the company that has already been spending a lot of money, and they take deep offense when it is pointed out they are not the kind of companies one is seeking to encourage.

MR. ROBERTSON: So the incentives go in, in the first place, to boost the morale of the taxpayer, and then you find out that he is very disillusioned when he sees it, and then it becomes a matter of whether it is worth the effort all the way around.

COMMISSIONER GRANT: On the question of incentives, I have myself likened incentives to

something along the same doctrine as Adam Smith applied to protection, that it was justified in infant industries provided that after a fair trial they could get to the point where they could stand on their own feet and compete with all their competitors. In that concept, would you give incentives any place in our fiscal policy?

MR. ROBERTSON: I suppose you can go back to the infant industry argument and wonder if they ever do grow up. Very seldom do the industries grow up with the protection, and I think this is the general feeling about them. I guess this is one of the bad points about the incentives. Once you have them they very often stay long after their usefulness has been served.

COMMISSIONER GRANT: We in Canada probably owe a good deal of our assistance in this very province to the protective measures we invoke as a matter of national policy. Would you not agree?

MR. ROBERTSON: I do not consider myself any authority on the question of powers.

MR. RUSSELL: The majority of the incentives are put in for a limited time, though, to answer your question. I am thinking of the three-year exemption on new mines. This runs out in three years; and these other incentives are put in for a specific period only and might tend to speed up something that would be done later on, but it causes the various companies to do it now rather than three years from now. That gets away from your point of an infant industry relying on protection too long.

COMMISSIONER GRANT: I do not think anybody rules out the fact that assistance is required in certain phases of our economy at various times. It is rather a question of what form that assistance should take.

MR. RUSSELL: And how long it should exist.

THE CHAIRMAN: The three-year mine exemption has been there quite a long time, and it has been renewed very frequently.

MR. RUSSELL: But it applies only for three years to a new mine, and then they are on their own.

THE CHAIRMAN: In the Act is it a temporary measure?

MR. RUSSELL: No.

COMMISSIONER PERRY: It has been a permanent measure since 1936, I believe.

MR. RUSSELL: Yes, it has been a permanent measure for a long time, but limited to a period of three years.

MR. ROBERTSON: I think one of the problems of the incentive area is it is generally assumed that legislation can be drafted to carry out the noble intent of the incentive idea. I do not think this is always the case, that you can deal with them in the statute too well. When they become overburdened with words, and if you do not have the word they are going to be much wider than was intended, and people come to a point where they just ignore them,

and the effect is lost. You would then wonder if you would want people making decisions on the basis of some of the smaller type incentives. Even the distressed area incentive raises some concern. I have spoken to some people who have been in a position to advise industry, and they have found some industries have taken advantage of this type of thing, only to find that when they got there they had overlooked the labour supply, and so forth. This is a much broader thing, but there are dangers lurking, I would think, when you do something to make the person make a decision, in taking his mind off the over-all project. It is a matter of how much you want to do that. So it is with difficulties. I suppose it is a matter of weighing all these problems, bearing in mind what we hope to attain.

COMMISSIONER GRANT: The opposition to incentives has been that they are discriminatory. I think that is the basis of the opposition.

MR. ROBERTSON: Perhaps they do not just work very often.

COMMISSIONER GRANT: If they were of general application, available to all, I suppose they could not be charged with being discriminatory?

MR. ROBERTSON: And perhaps at that time they cannot be regarded as incentives, if we take this definition we were discussing before. This is a bit of semantics.

MR. RUSSELL: There are two types of incentives, too. One is the Income Tax Act is full

incentive to the taxpayer. The other gives it with one hand and takes it back, substantially, with the other. I am thinking of incentives such as those provided under the gold mining assistance to marginal producers, the receipt of which is taxable as income in the hands of the recipient. The same applies under the Vessel Construction Assistance Act, which in turn creates additional taxable income. It might be taken back again.

THE CHAIRMAN: Not with regard to the mines, because I think depletion is allowed, so they are only paying about ---

MR. ROBERTSON: Two-thirds of half of it could come back.

THE CHAIRMAN: Moving to double taxation in the brief, I suppose we will always continue to have trouble with this matter of double taxation. You point out it depends on the concept, maybe, as to whether the tax stands by itself or is merely an extension. But it also, I think, depends upon the old problem which you mentioned here, of just where the incidence of the tax lies, and while I suppose one can have all kinds of views on this, if one follows Mr. Gossman, who I think split it 60-40, or something of that kind, I think that he was fairly arbitrary in his split, but he followed the authority as well as he could. If one had regard to that, and the Canadian dividend tax credit, I would have thought the mathematics would result in there being very little double taxation.

MR. ROBERTSON: Yes, we go quite a long way in recognizing the theory of double taxation, and, as I think we try to mention here, sometimes the theory is perfectly appropriate and in other cases it does not seem at all appropriate.

THE CHAIRMAN: We have heard many people who say that the dividend tax credit should go out in order to totally do away with double taxation, or that dividends should be deducted, or that if the corporation is taxed, the dividends should not be taxed, and so eliminate double taxation. But, I do remember some years ago that there was a debate in the House of Commons as to the amount of tax that was passed on, and I do not think that everybody took the view that all the tax was borne by the shareholders. I may be wrong, but I think, generally speaking, it is pretty well acknowledged now that some corporation taxes are passed on to others than the shareholders, and I would suspect that if a system came forward which did what was advocated of completely eliminating alleged double taxation by a number of devices, it would be very quickly pointed out that it was going beyond the elimination of double taxation and providing a credit to the shareholders.

MR. ROBERTSON: I think you can take a position in this situation and put up a very good argument all the way through, but I think what you

say, Mr. Chairman, is correct. I think you have probably found that many of us fall into the trap of arguing double taxation in one breath and saying we should cut corporate taxes because they increase prices, -- and people are just a little bit shocked when this complete inconsistency is pointed out to them. But, if you go too far in one direction, you meet head on with the other argument.

THE CHAIRMAN: We had two groups of witnesses the other day, one following the other, and both said that to the extent corporation taxes were reduced the full amount of the reduction would be reflected in the price of their goods.

MR. ROBERTSON: Did they say by how much?

THE CHAIRMAN: They said to the full extent that corporation taxes were cut, the prices would be reduced.

MR. ROBERTSON: There have been some computations suggested -- they are just rough, and I cannot vouch for them -- to the effect that a 10 per cent differential in tax works backwards with the idea that if it is all passed on -- there is a 5 per cent after-tax profit, and it can be worked back so that a 10 per cent differential in tax amounts to just about a one per cent difference in price when you are dealing with a 50 per cent tax rate. I do not know if too many have measured this through, but that could be a very significant difference in some situations. But, I understand

that in a lot of things decisions are made, and it is said, "Why, there is a lot more leaway within the one per cent involved".

THE CHAIRMAN: The point I am making is that the shareholders would not benefit -- that is, according to these witnesses, at any rate.

MR. ROBERTSON: No.

COMMISSIONER PERRY: This business of price flexibility is very confusing. At the other extreme we have had people expressing doubts as to whether the manufacturers would change their prices very much excepting under severe competition if the manufacturer's sales tax were removed.

MR. ROBERTSON: I have noticed following your hearings, gentlemen, that the theory very often seems quite a bit at odds with what the taxpayer says. I notice that some were saying that the manufacturer's sales tax did not mean very much on machinery, and so on. I suppose it just depends on one's own experience. I suppose where there is a conflict between the economist and the taxpayer in this case you are going to take the manufacturer's position.

THE CHAIRMAN: And I would think the tax would vary very greatly depending upon plant cost and selling price?

MR. ROBERTSON: Yes.

THE CHAIRMAN: In discussing the passing on of tax, of course, I am curious -- and I do not think we have heard much evidence on it -- as to whether the U.K. system of corporation taxation

in its really being of advantage to shareholders means that there is no tax passed on to customers or have seen any indication that the people in Britain believe that some tax is passed on. Do you know anything about that?

MR. ROBERTSON: No, I do not believe I do. I have not thought it through on that basis. I think part of the outlook on the British tax system is a myth. It is a beautiful theoretical concoction, and I think only the British would be capable of sustaining it. It is a marvellous thing, but, practically speaking, there is a profits tax which is 50 per cent now, and I cannot see any way of distinguishing it from our own corporation tax. However, there are other theories of passing on and grossing up which causes some people on this side to look at it longingly. The key, I think, is that they think the United Kingdom dividend is the same as our dividend, and they see what a big dividend is distributed. They think of it as cash in hand as we think of our own dividend. I think this is where a lot of the confusion is caused.

COMMISSIONER PERRY: We have had people who would think that the grossing up feature might produce higher taxes for some taxpayers, but they have said that this is a system that they would be willing to tolerate.

MR. ROBERTSON: Oh, I think it would. What are we driving at with this thing? Sometimes

I wonder if we know. I know that I wonder sometimes -- let me put it that way.

THE CHAIRMAN: At page 9 you say:

"Opinions as to whether the taxing of corporate earnings should be such as to induce their rapid distribution or retention, or whether it should play as neutral a role as possible, appear to depend on one's view of questions extending beyond the realms of taxation."

You avoid saying whether you believe -- in fact, you have no opinion -- whether or not the present method of taxing corporations is neutral as between distribution and retention. In some circumstances it is one or the other, but I wonder whether on balance it is reasonably neutral or not.

MR. ROBERTSON: I think it is about as neutral as you can get it. There may be some ways of adjusting it to specific instances, but in theory, at least, it is close to being neutral. Other countries go out of their way to force distribution, I think, and a lot of the decisions about whether they should be forced out or not depends on such things as whether people should hold shares, and it has the broader social outlook. In a narrower sense, some people look at the forcing out of profits with favour because they feel that the decision with respect to reinvestment should be

made by others than the management; that the money should go back to the shareholders. I am not so sure.

THE CHAIRMAN: We have had people telling us that the lack of capital gains tax or the higher tax on retention, tends, under our tax system, to encourage accumulation, and to the extent that there is an accumulation there is likely to be an untaxed benefit to the organization, which indicates in their minds that the tax is not ---

MR. ROBERTSON: Yes, when I take into account the fact that there is no tax on capital gains, I can see their argument -- does the taxation of corporate profits cause any upset in new charity, or is it because capital gains are not included in income?

THE CHAIRMAN: Yes, I agree. Perhaps the system is not neutral. You are quite right.

MR. ROBERTSON: The Commissioners may wish to look at the Australian system for private companies. I do not know whether it has or not. I have a little example here. It is just a theory, if you are interested in it.

THE CHAIRMAN: Yes, I have an idea that private companies have special tax treatment, and I cannot remember whether it is -- this concerns partnerships, does it not?

MR. ROBERTSON: I do not purport to know all the details of it, but in Australian companies, for tax purposes, seem to be divided up

into private companies which seems to me companies of up to 20 shareholders, and non-private companies which essentially seem to be those which have their shares listed or those that do have public participation. The taxing process for the private -- first of all, the general tax is a flat income tax of 35 per cent on the first 5000 pounds, and 40 per cent on the balance for the public company. In that way it seems to measure up to ours. With respect to the private company, the primary tax on the taxable income is much the same as we know it, and it is between 25 per cent and 35 per cent. This gives one a figure of distributable income. Then there is a retention allowance that is computed, and you are allowed to retain in this allowance 10 per cent of income from property. Other income is taxed at the rate of 50 per cent on the first 1,000, 40 per cent on the second 1,000, and the balance at 35 per cent, and you are allowed nothing for the retention of dividends from another company. You add all these up and you arrive at a figure that is a retention allowance which you subtract from distributable income, and you come down to a figure which is called "sufficient distribution".

Now, if you distribute that -- well, it just goes out and that is the end of it, and you only pay that primary tax I mentioned earlier. If you do not distribute it, then such of this sufficient distribution that is left is taxed again at 50 per cent.

I would imagine it is a very effective way of forcing out undistributed income.

THE CHAIRMAN: Yes, but I am curious why they would force out undistributed income -- well, I can see where it might not be the case in small companies. Private companies are not necessarily small companies.

MR. ROBERTSON: No. I have here figures that I can leave with you, but I have a theory -- I hope I have made it clear, but I can give you an example in numbers if anybody would like to write it down.

THE CHAIRMAN: You can leave it with us.

MR. ROBERTSON: I believe one of the main purposes is to simply get the money back out so that it can be hit by the individual taxes. Apparently this is an improvement over what they used to have. I was speaking to someone from Australia recently, and it seems that they still have difficulties with this, but it is better than what they had ten years ago.

THE CHAIRMAN: It may be their answer with respect to avoiding the combined effect of Estate taxes and income taxes on death, because if one forces the surplus out of companies that problem has gone.

MR. ROBERTSON: Yes, it may be.

MR. RUSSELL: It may be interesting to note that these figures that we will leave with you start off with a figure of taxable income, and

after deducting the corporation taxes and the retention allowance which the company is allowed to keep, and what is deemed to be sufficient distribution to avoid further taxes by the company, the end result is approximately 50 per cent of the original taxable income. This is interesting in view of our Section 105 provisions. They are suggesting it is roughly half of the income before taxes.

THE CHAIRMAN: They are forcing out 50 per cent.

MR. RUSSELL: Yes, and the retention allowance in taking over 50 per cent means they are forcing out approximately 75 per cent of the income after taxes. If they do not, then the company is quite heavily penalized.

THE CHAIRMAN: And the shareholders can turn around and lend it back to the company?

MR. RUSSELL: Yes, that could be done.

THE CHAIRMAN: What they are doing, I would have thought, is avoiding double taxation on accumulation.

MR. RUSSELL: And it is a very powerful incentive to distribute because the part that is not distributed is taxed at 50 per cent which is higher than the basic corporation tax of only 35 per cent. Putting it in another way, if no distribution is made at all, the maximum tax goes from 35 per cent to about 55 per cent, so I would think it is a very, very powerful incentive.

MR. ROBERTSON: Or a stick. I do not

know whether you should use the word "incentive" or "club".

THE CHAIRMAN: On page 10 you make a statement that I do not understand. It is as follows:

> "One generalization about economic opinion which it is probably safe to make is that most economists agree that taxation of profits produces less empediment to economic growth than taxation which is levied on, or measured by, the value of specific factors of production."

Now, I read that with interest because I noticed that you later on -- perhaps it is here -- refer to the possibility of shifting the social security tax on corporations from a tax on profits, to a tax on payroll in line with the United States practice. Would that not run counter to this generalization?

MR. ROBERTSON: Yes, it would.

THE CHAIRMAN: But despite its running counter it may have enough merit ---

MR. ROBERTSON: Yes, for other reasons.

COMMISSIONER PERRY: Is this a conclusion that emerges specifically from the discussion at the Brookings Institute conference?

MR. ROBERTSON: No, there was very little that emerged conclusively from that. I think one did get the feeling -- you are referring to paragraph 31 again?

COMMISSIONER PERRY: This is the indirect

tax argument in a narrower focus, and I am just wondering whether this observation was based on something that emerged from that conference, or whether it was something more general.

MR. ROBERTSON: Something more general, but I think -- I am not sure whether it would be supported as a concensus of that meeting, but they did more or less conclude a switch would not be beneficial over-all, but the switch to some indirect taxation in the United States might help as their balance of payments. There seemed to be a conflict. It would be helpful, on the one hand, but not worthwhile, going through the steps to get that benefit.

THE CHAIRMAN: I do not understand what you mean when you say:

> "Here the possibilities of base-widening to permit lower statutory tax rates run head on into the desirability of removing tax from the profits of production."

MR. ROBERTSON: I think what is meant there, Mr. Chairman, is that simply to broaden the tax base you use the means whereby you take into taxation everything that you can, and ignore the fact that perhaps the taxed items are being used by industries. I think this is what is said in Mr. Gordon's budget of last year, which was a base-broad budget. But, it backfires a little bit when you start putting in such things as production machinery and so forth.

THE CHAIRMAN: It would be very useful

for you to point out that if one follows the theoretical viewpoint that one must not tax the process of production, because one causes double taxation by so doing, that we just shrink the revenues very seriously indeed, and really the conclusion that it leads to is that of some compromise.

MR. ROBERTSON: Yes, I think that is the only answer -- a reasonable compromise.

THE CHAIRMAN: This is an argument I had not heard before where you say:

> "About the only argument -- outside of the need for revenue -- which might be advancedin support of taxing machinery and equipment is that not to do so provides, in a period of heavy unemployment, an incentive to automate more rapidly than might otherwise be the case."

I wonder whether the weight of sales tax would actually have any effect on that? I would suppose that it would, like everything else.

MR. ROBERTSON: Everything has an effect of some sort. I am not sure how we determine how great it is.

THE CHAIRMAN: A great deal of what we have heard has been a debate between tax on income and tax on sales, and I am glad you have referred to that here. You point out a great shift in the results of a recent survey -- I did not know much about this survey -- where it seems that the public view now is that if there is an increase in taxes it should be in indirect taxes.

MR. ROBERTSON: Taxes on luxuries and corporations.

THE CHAIRMAN: Yes, we have wondered what those were.

MR. ROBERTSON: It is something that the person who is being asked the question does not buy.

COMMISSIONER WALLS: It seems to me that over and above this emphasis on a luxury tax, and while you make no specific recommendations regarding sales tax, that you do put extra weight on three main items. I would like you to state whether I have interpreted you correctly here. The first is that we should not tax producer supplies and machinery and apparatus for production, but that we should tax office equipment and furnishings because of the composite use of them. The second is that we should give a great deal of attention to a visible retail sales tax. The third is that we should only consider the value-added type of tax if we can foresee that consumption taxes might be forced up to 25 per cent. Am I right in thinking that these are the three factors dealing with sales tax that you put more weight on than anything else?

MR. ROBERTSON: I would think that that is correct. I have tried not to over-weight everything, but it did come out that way. I do not think I could disagree.

THE CHAIRMAN: How do you think the combining of the federal and provincial sales taxes at the retail level would look to the provinces? Have

you any views, as to what the provincial tax officials or the provincial politicians might see in such a suggestion?

MR. ROBERTSON: This would be at best just a wild guess.

THE CHAIRMAN: Let us have your wild guess.

MR. ROBERTSON: I do not think, sir, that they would be put out completely by it. I think a lot of the officials now are working quite closely together. There is more co-ordination at this level than you might expect, and I think they concede the idea of efficiency emerging from this. There is a blank wall, perhaps, at the provincial level but whether there is or not at the federal level I do not know. I would be more concerned about the federal government's wanting to give this up, in the sense of switching in this field.

COMMISSIONER WALLS: You realize, of course, that if you put on this so-called luxury tax you are going to get some items up into the 25 per cent bracket having regard to both the provincial and federal taxes. Your provincial tax is 11 per cent, which is, according to Professor Due, 5 per cent retail plus 5 per cent manufacturers' tax, plus a few luxuries at 10 or 15 per cent, and in bringing that down to the retail level you are going to come up to about 24 per cent on some of your items. If it is going to apply only to certain items -- if there is to be a graduated sales tax on luxury items -- then would you suggest that you switch the value-

added as soon as some of these items reach the 25 per cent limit?

MR. ROBERTSON: First of all, I have not made any suggestions about a luxury tax, but in referring to this survey of the Gallup poll I gather this would happen. I suppose there is nothing inconsistent in having these luxury taxes show up and be quite visible. I would not think that you would switch into a value-added tax just because a few of them went up there.

COMMISSIONER BEAUVAIS: Is it not a fact, Mr. Robertson, that in some states they have a luxury tax which is very high, and which is shown -- which is quite visible?

MR. ROBERTSON: Yes, I think that is correct. I would think that if you are taxing luxuries as a policy objective you would want to show it. It is a sort of equitable idea that you should tax -- well, I do not know what people consider to be a luxury.

MRS. McGREGOR: The purchase tax in England during the war did this, and singled ---

COMMISSIONER WALLS: Yes, it was as high as 99.0 per cent.

MRS. McGREGOR: They taxed such things as cosmetics. It depends upon your definition.

COMMISSIONER PERRY: If you make the tax high enough it becomes a sort of status symbol.

COMMISSIONER GRANT: The definition of a luxury also depends upon the sex of the person defining it.

THE CHAIRMAN: Regarding the view of the provinces in connection with this, right here you say that they might be impressed by the efficiency. Would it be favourable to them to collect the taxes? Many have told us that they think the provinces would like to collect the tax, and yet I wonder, when they say that, whether the advantage might be offset when they collect it because it would appear to be a provincial tax, and I would not think that the provinces would like to have their citizens believe that they were receiving the entire amount of the tax.

MR. ROBERTSON: I think that is quite true, but there could be some sort of organization that would sort of help them out of that spot.

- -

THE CHAIRMAN: I think that might be done by definition.

MR. ROBERTSON: I would think this would help. I do not think they would welcome it with open arms by any means, but I do not think there is a brick wall.

THE CHAIRMAN: You would not be concerned over any possible feeling that this dried up the area to a very great extent, that it would be hard for them to tap retail sales taxes much further?

MR. ROBERTSON: I think that would be a concern of mine if I were a provincial official. I would have to weigh this against what benefits I would get in other directions. I could imagine that what they may see over a period of time is that the provinces would perhaps creep up the percentage points, perhaps pushing the federal government out of the field over a very long period of time. Then you would have the two big taxes, the income tax and the sales tax, and the provinces would not be pushing perhaps so hard on the income tax and you may get a balance.

If you look at it in that span of time, then you see it was originally high because of the fact of it being both federal and provincial. Then this would open the way for the provinces to push up. It depends over how long a time you look at this.

COMMISSIONER PERRY: I think the income tax provides some historical precedence here.

Most of the provinces were in the field before the federal government, but now after 45 years most of the provinces concede that the federal government does have some right in this area.

MR. ROBERTSON: Reluctantly.

COMMISSIONER PERRY: In some places reluctantly, yes.

THE CHAIRMAN: Is there anything further in this area?

I would like to go to personal taxation, so perhaps this would be a convenient time at which to take a break.

--- Short recess.

THE CHAIRMAN: Mr. Robertson, I come to personal taxation now. We have got away from grubbing around with what happens in business and we come to what affects us a little more intimately. I must say that I think it brings us right into your Appendix A, which seems to me to be a very interesting exercise indeed -- a comparison of our tax burdens with those of other countries.

I was interested to see that you, in getting at Canadian taxes, deducts family allowances received as being what one calls negative taxation. If you are going to do that, why should one not deduct pensions?

MR. ROBERTSON: Mr. Chairman, I think a good part of these comparisons arise just because

we try to seek some basis of comparability. There is no reason why one thing should be put in and another thing should be taken out except to try to get this into country comparisons. I agree you could put one in and leave out the other as long as you attempt -- and I stress the word attempt -- to get them reasonably comparable.

THE CHAIRMAN: It is rather startling that the burden in France is as light as it is, taking the bottom line. I think I know the answer to it, but I am not sure. I think the reason for that is their split interest basis where they split not only between the adults but also bring the children into the split and thus keep taxation away down.

MR. ROBERTSON: I think that would be a major factor as would their reliance upon value added taxes.

THE CHAIRMAN: And also likewise that applies to Italy to some extent. It is very noticeable in all these parts that we do not pick up much steam in taxation until we hit a level -- we do not tax up to the weight of the United States really until about $10,000 or little less than that.

MR. ROBERTSON: I think it is a little less than $10,000, but it is in that area.

Again, this depends so much on the individual example that one takes. The result might be entirely different if one took different sources of income, capital gains, and so forth.

THE CHAIRMAN: Of course, in computing United States taxes, one splits the income for a family.

MR. ROBERTSON: Yes.

THE CHAIRMAN: I was curious as to why when you come to exchange rates (which are cost of living exchange rates, I think) that you would choose $3.41. I have always been rather under the impression that some people when traveling this continent and Britain, in the course of changing jobs, they are inclined to think of the pound in terms of what it will buy for them as being worth somewhere like $5 or $6. I imagine you have heard that too?

MR. ROBERTSON: This is right at the heart of the difficulty in making inter-country comparisons. A person receiving X dollars in a particular job may be in an entirely different income bracket from a person doing the same job in another country, and to make this translation is not hopeless, but extremely difficult. For that reason we took the basic work of the Economic and Social Research Institute, and they took Canada into it. They tried to overcome that problem, and it was their figure that we took. I cannot vouch for it as being any better than a $5 or $6 figure or a straight exchange rate figure.

THE CHAIRMAN: I would not have thought it could have been as good as the $5 or $6 figure, because the $5 or $6 figure is based on the appraisal

of English companies in setting salaries for people they send across the ocean, and certainly they do not intend to pay them any more than they need, I would think. Perhaps they feel they should receive more money for luxuries than they would get at home, and perhaps that is why there is a $5 or $6 figure.

MR. ROBERTSON: This may be. I have tried on one or two occasions to discover just what basis companies use on making transfers. I find that they pretty well have to -- by guess and by God, very often -- try to reach some conclusion, but I do not think any of them are very pleased with just what they come up with, particularly since the income tax is only one of the things involved. You have different tax levels and different commodities, and so forth, and you have a certain standard of living expected of a person in a job in one country, perhaps, that is not expected in another country.

THE CHAIRMAN: I wonder if the way to compare English tax rates is not to look at what is left after taxes and translate that at a higher figure than the $3.41, at the $5 or $6 figure. I have never tried to do it, but I suspect if I did that the disparity would not be as great as it seems to be.

MR. ROBERTSON: That might well be the case.

We have tried, by giving some other approaches here -- segments of people in fifths

of income classes -- we have tried to show how it worked out on another basis. This was one of the problems we were aiming at in setting this up.

THE CHAIRMAN: Yes, I thought the figures you set out in Table 3 were very interesting, and essentially make the point, I think, that the average income in the United States is fairly high, that we are second, and that the United Kingdom is third. Despite the difference between ourselves and the United Kingdom with regard to the average income. They tax the lowest fifth on less money than we do; they tax them a little more than we do.

MR. ROBERTSON: I do not know just what conclusions can be drawn from this type of material that is useful in all cases so that one can make definite statements with any degree of assurance. I think if these tables point up anything, they point up that matter.

COMMISSIONER GRANT: With regard to Table 3, if the assessed income classes under $5,000 in Canada are actually 63.8 as against the United States 47.3 -- is that right?

MR. ROBERTSON: You have added up the first. Yes, I think that is right. I have not added them myself.

THE CHAIRMAN: The first three you have added?

COMMISSIONER GRANT: The first two.

THE CHAIRMAN: That is 42.99 down.

MR. ROBERTSON: Here is another problem. What is included in the gross or assessed income? This is another variable which is not taken into account here.

THE CHAIRMAN: The United Kingdom would take in earned income relief, I suppose, because it is written in the law as an exemption.

MR. ROBERTSON: And family allowances, I understand, are brought into this income -- which would be another factor. Then there is the additional problem to which one of the footnotes refers, that this does not include the State income tax in the United States. There were no provincial income taxes in Canada for the year in question, but as such, I think it is the term that should qualify that.

COMMISSIONER BEAUVAIS: There was in Quebec, I think.

MR. ROBERTSON: Yes, I am sorry -- other than Quebec, but the money was still going to the provinces. It is difficult to know just how to handle that.

THE CHAIRMAN: I see that our staff say that this procedure provides an interesting and positive contribution to this Commission; and I think it is very useful too.

MR. ROBERTSON: Thank you, Mr. Chairman.

THE CHAIRMAN: On page 18 you state:

" There is little evidence to suggest that the use of graduated rates as an automatic stabilizing device has played much part in the establishing of rate structures in the past."

You are not inclined to believe that in setting rate structures people who have done so have had much regard for economics in the matter?

MR. ROBERTSON: I do not know of this happening. It could have been a factor. I am relying in good part, I must admit, on the statement by Mr. Pearse in his paper at the 1963 Conference. It appeared to be his opinion that this was true, and that any stability factor that was involved in the setting of the rate structures was fortuitous.

THE CHAIRMAN: You suggest that:

"...it is here that can be found the roots of Canadian disenchantment with the income tax as a means of raising more revenues."

"Here" means it is the progressive system that provides the disenchantment.

MR. ROBERTSON: The graduated rate system. I attempted to distinguish -- I do not know if it is a valid distinction -- between graduated and progressive.

THE CHAIRMAN: That is an increase in commodity taxes rather than income taxes.

MR. ROBERTSON: I have the feeling this is one of the reasons why proposals for commodity taxes

were raised. I do not think it is very often stated in that way.

THE CHAIRMAN: One thought of yours is quite interesting, namely that if we all see ahead of us the prospect of increased earnings being taxed at increased rates, it is not a very cheering prospect to believe that tax increases will cause that situation to worsen, and I can quite understand why if that is what we see ahead of us we would tend to move over to something more proportionate. Is that what you are thinking of?

MR. ROBERTSON: Yes, that is the general feeling.

THE CHAIRMAN: Everybody in the country believes he is going to earn more income.

MR. ROBERTSON: I believe they do. Hope springs eternal in that direction.

COMMISSIONER BEAUVAIS: On page 22 in the second paragraph when you talk about steep progression designed to combat inflation, it is customary to increase the rates in those periods in order to decrease the purchasing power, but I always wonder why the government should not resort to enforced saving instead of increasing the rates, as they did during the war, in such a way that they would not increase their expenditures, because it is very difficult for a government to decrease expenditures in a time of recession. Why was it never suggested since the war that there should be enforced saving, compulsory saving, which would be

reimbursed by the government in a time of recession, in order to increase the purchasing power at that time?

MR. ROBERTSON: I would suppose, Mr. Beauvais, that probably there are pretty difficult administrative problems with enforced savings. I had no experience at all of taxation at the time enforced savings were imposed, but I do not think they were too popular. Just the idea of forcing people to save is perhaps unpalatable.

COMMISSIONER BEAUVAIS: Do you think it would be less popular than increasing the rate? Do you think forcing people not to spend would be more unpopular?

MR. ROBERTSON: I think it might be, but then you have these savings and people move and change and again, I suppose, this is a balance between administrative feasibility and a theoretically desirable goal.

COMMISSIONER BEAUVAIS: Though it was done during the war. I do not know if it presented difficulty in administration. I cannot say.

COMMISSIONER PERRY: Yes.

MR. ROBERTSON: It did?

COMMISSIONER PERRY: It certainly did. The real difficulty is to make an allowance for the people who are already carrying on a very high rate of saving and for whom the compulsory saving is an extremely heavy burden.

MR. RUSSELL: If it were an alternative between raising the rates and compulsory savings, I think compulsory savings would be more favourable, more acceptable to the taxpayer provided they were not extreme. I think they were a little extreme during the war, but that was a case of necessity.

COMMISSIONER PERRY: As far as I can recall, nearly every country tried this during the war, and I believe it is only South Africa that has tried it for one year since the war. I would think if it is a little used measure there must be some pretty good reason for it being little used.

MR. ROBERTSON: I think just the idea of compulsion, in a period other than that of wartime necessity, would leave it open to some objection.

COMMISSIONER BEAUVAIS: But I think if you increased the rate that is a sort of compulsion to pay heavier taxes, too!

MR. ROBERTSON: One cannot disagree with that.

COMMISSIONER PERRY: There is another sort of psychology. Some people accept it that it is the function of the state to levy taxes, but they do not accept that it is the function of the state to force one to save. The taxes, therefore, oddly enough are more acceptable as an exercise in government.

MR. ROBERTSON: It is a conflict in philosophy.

MR. RUSSELL: Particularly when a

substantial part of tax revenue may be going into a system for providing a pension for one later on anyway.

THE CHAIRMAN: On page 24 you refer to the disposition in democratic countries towards personal income tax on structures which produce regression, and I wonder if it has just been a sort of following of the leader which has produced this result. It is very interesting that all the lines on your charts go up -- not together, but roughly together. I suppose there is no country which does not have graduated personal tax rates in an upward direction which has personal income taxes. Is that correct?

MR. ROBERTSON: I think that is correct, yes.

THE CHAIRMAN: It would seem to me then that the reason for it must be stronger than just because the other fellow is doing it, but I imagine that is a pretty strong reason, myself.

MR. ROBERTSON: Yes, one always tends to look at one's neighbours. Although Mr. Anderson in his submission put this on a rather interesting ground.

THE CHAIRMAN: Yes, I thought so. Mr. Anderson has worked out the application of the democratic process to the graduation of personal income tax rates on a mathematical basis, which you may or may not have seen. I have not seen it, but I have had it explained to me by Mr. Anderson and I was going to ask him if he had a written document

to support it.

MR. ROBERTSON: I have not seen that, Mr. Chairman.

THE CHAIRMAN: I like your term "income reservoirs". I have really been seeking something of that kind myself because it is a very important matter to the whole basis of our taxation whether, when we permit the deferment of tax to what we call the reservoirs, whether we can advise separate taxation up to the point of the reservoirs and another tax when it comes out of the reservoirs. It would seem to me that time is a very significant matter. It would seem to me that one cannot say that one is going to get the tax anyhow, because the present value of the future payment is different from the future value and must be taken into consideration.

MR. ROBERTSON: Yes.

THE CHAIRMAN: I shall try to use that term; I think it is a good one.

MR. ROBERTSON: I make no claim for it being original.

THE CHAIRMAN: Well, I will give you credit for it.

I would like to draw your attention to the efficacy of graduation, of the situation when little or no graduation comes about. I think one of the advocates -- and I think I am not unfair in calling Dr. Whitton an advocate because you mentioned his name in a footnote -- looked at it in regard to what he felt was unfair.

MR. ROBERTSON: Yes, but it struck me that people who found fairness in it had been particularly well acquainted with technical problems. I do not know whether it was conscious relationship, but it seemed to be there.

COMMISSIONER WALLS: The rate structure dictates, it seems to me, high pre-tax salary in order to achieve expected after-tax income. It would seem to me the whole wage structure is based on the trade and labour organizations and what they are able to negotiate, and then the people in non-negotiating occupations relate their salaries to them. Then the professions put their wages above that. I wonder how many professions have considered the after-tax position as a basis of their fees?

MR. ROBERTSON: What was in mind here was, say, very large companies, companies working on the same line of reasoning that you are, that the status is there in the salary itself. However, I think there must be some feeling that the after-tax symbols of status play some role -- symbols such as different housing and different cars, and so on. Of course, they have to get up higher in order to let them achieve that different standard of living. It may not be inconsistent with your reasoning, but I think there is a little of that in the situation and you have to leave room for all the graduations of occupation in various companies.

COMMISSIONER WALLS: You think what is important to these people is quality of living

standards rather than growth salary standards? In other words, you think it is the type of home they live in, the type of car they drive, and so on, and therefore they have to give consideration to net income after tax in order to be able to purchase these things? You think it is these things that create status rather than the fact that one is earning $50,000 a year, or whatever your gross salary may be?

MR. ROBERTSON: I would think it would be a fairly important factor, not necessarily to the exclusion of the pre-tax salary; I would not go that far.

THE CHAIRMAN: It is quite amazing, I would think, to note the high salaries that are being paid in the United States under the very high progression of tax rate structures. A very large number of G.M. executives are up in the $400,000 range, or thereabouts. It would be interesting to know, and I would imagine it to be a fact, that what they had left was a relatively small fraction of that. I was curious as to how a company would justify making such a very heavy charge for such a very small benefit. I suppose it is merely the forces of competition and the market that dictate it.

MR. ROBERTSON: It may well be that.

THE CHAIRMAN: To put a charge of something like $400,000 against a company for a man who receives less than $100,000 benefit, or less than $100,000 seems difficult to explain to

shareholders.

MR. ROBERTSON: And they have to push that man up high enough to let the people below get what they expect to get.

MR. RUSSELL: The deduction in the top marginal rates of the income tax which has apparently been approved in the United States will mean higher corporate tax. To give them higher net income this is necessary.

I am talking theoretically, of course.

MR. ROBERTSON: I think it would be over a period of time that any adjustment would take place rather than immediately.

THE CHAIRMAN: You point out on page 27 that:

> "Retention of a graduated rate structure will obviously require continuing sacrifices of consistency, simplicity and efficiency in the technical application and administration."

I wonder whether you were not overdoing the benefits which would flow from a proportionate tax. I recognize graduation does cause difficulties all right, and must cause us to shore up certain weaknesses which emerge at a high rate of taxation when people are trying to avoid high rates of tax and causes us to require averaging, and things like that, but we would still have difficulties with personal tax. We are not going to cure them all.

MR. ROBERTSON: That is quite right.

THE CHAIRMAN: I just wonder if we cure enough with this to justify your statement?

MR. ROBERTSON: I think it is a matter of judgment just where the balance lies. The statement as you read it, I think, possibly is stronger than it might otherwise be made.

I am sure there will be a continuing sacrifice. How great that sacrifice is, I do not know.

THE CHAIRMAN: You have suggested that in the foreseeable future we would always have some measure of graduation by virtue, first of all, of exemption and, secondly, of a surcharge. So long as you had graduation resulting from that, you would need pretty much what we have now, would you not?

MR. ROBERTSON: You would need something, I suppose, between a base rate and a surtax. It is only when you get down to numbers, to the people involved, that you find what you must weigh against advantages.

THE CHAIRMAN: I think you have picked up Mr. Anderson's statement here, and I think it is a very important one, for he draws attention to progression:

"...the purpose of progression
being redistribution of income" --

and it would seem to me there is not much denial of that principle. It certainly does redistribute income and I would have thought it was intended to redistribute income, but I recognize it must be taken along with family allowances and pensions because by itself it is only part of redistribution. That is right, is it not?

MR. ROBERTSON: I would think so. It perhaps does not cause as much redistribution as we sometimes think.

COMMISSIONER PERRY: You are proposing the use of social welfare schemes as an alternative to the graduated rates for redistribution? As I

--

--

--

look at it, without a graduated element in the tax structure, the redistributive effect in the case of family allowances is to take tax from people who have no children and give money to those who have. In the case of the old age pension, it is a transfer between ages of the population. What else is there? There is the health scheme, I suppose, which is a transfer between those who are sick and those who are well. There is an insurance element in it also. I think they leave out the element of the redistribution between income groups if there is a graduated element in the tax structure.

MR. ROBERTSON: Even the progression created by exemptions on a flat rate would have an element of redistribution, a small one of course.

COMMISSIONER PERRY: Yes. It says "some elements".

MR. ROBERTSON: Of the redistribution between income groups, yes. Then one wonders whether the redistribution between income groups is the significant line of redistribution or whether it is more significant that it be to these special groups that have been singled out -- the families, the people over a certain age, and the unemployed. You might visualize it as a diagonal redistribution rather than one that just drips down to ten to eight to nine to seven and all the way down the scale.

COMMISSIONER PERRY: I agree there are two ways of looking at it but I must say I hardly

think of them as alternative ways. The things are quite separate and have distinctive characteristics. I must say that I read Mr. Anderson's remarks in that vein, too -- that he really is arguing that the graduated rate structure does have the income redistribution effect. It has more redistribution effect if the money is going out in these welfare payments.

MR. ROBERTSON: One can ask, of course, if there is any actual. There is no cash distribution caused by the graduated rates, is there? It is a sort of negative type of redistribution. No money actually flows from the $50,000 to the $25,000 to the $10,000.

COMMISSIONER PERRY: Not directly, no. However, then you have to examine the texture of your expenditures, leaving out a system of welfare payments. It has been said that one of the real difficulties during the depression, for example, was that high taxes were levied in order to pay interest on government bonds and a lot of money went back to the higher income levels, and was not spent in the way in which we would think was intelligent spending nowadays. So there is a redistributed effect which ultimately you have to take into account for government expenditure.

MR. ROBERTSON: I suppose it comes down to whether the redistributive effect from graduated rates is significant, and how significant it is in comparison with the others.

COMMISSIONER PERRY: There is the -

quantitative question too, but I was assuming there was some element in it.

24

THE CHAIRMAN: You are suggesting, I think, Mr. Russell, there are not as much occurrences as they may be as some of the things they did here. I am looking at the paragraph at the top of page 30, where it is stated:

> "The essential point of these observations so far is that these schemes are probably performing, or are capable of performing, much more efficiently and adequantely than the present graduated rate structure of the income tax, the essential function of the redistribution of income"

-- that it means both.

COMMISSIONER PERRY: I am saying it is a different kind of redistribution. If you were financing family allowances through a sales tax, for example, giving a fairly proportional tax, then the kind of redistribution that would be going on would be taking money from people without children and giving it to those with children; and this is not the kind of redistribution you think of within the income scale as happening when you have a graduated income. In other words there are different types of redistribution.

MR. ROBERTSON: Yes. However, is the effect of progression again. I am thinking of an exemption plus, which still does that, though to a markedly less extent. It does not eliminate it, but

-2

it certainly modifies it.

COMMISSIONER BEAUVAIS: To pay family allowances the money does not come necessarily from people not having children. If it is financed by a sales tax, then the people having children will contribute themselves to the funds to pay back some of that money; and, moreover, the person not having children might pay a very low tax or no tax at all.

MR. ROBERTSON: That is correct. It is not just a matter of having children or not, but the age of the children and so on. It is a re-distribution, perhaps, between age groups as much as anything else.

THE CHAIRMAN: In discussing personal tax rates, I think it must be in the appendix, you point out the difference between the tax on two individuals, where one earns income in the one case, and in the other case where they both earn income, and you show there was quite a different tax -- which is the usual argument one hears in favour of spread income. Would it be fair to come to the logical conclusion from that that split income seems to suit better than any other way of taxing income?

MR. ROBERTSON: I hesitate to be categorical about anything after I have read through this. As a married man, you probably agree. I suppose any idea of some sort of flat rate concept is a short cut to the same thing.

THE CHAIRMAN: There would be no purpose

to it.

MR. ROBERTSON: No.

THE CHAIRMAN: But as far as I can see, Canada is about the only country which taxes individuals the same, without regard to the family. Most other countries seem to add together and tax the aggregate; but still split -- notably France, Germany and the U.S.

MR. ROBERTSON: We have recognized the family unit indirectly with the exemption structure, and so on. This is part of the problem I suppose the Commissioners have thought a considerable amount about: What is the proper taxing unit. Is it the individual, the , or the family unit? It is all these insoluable things that you cannot solve completely. You just have to reach some useful break-up point.

THE CHAIRMAN: If you have anything further to present on that we would be glad to receive it, because it is certainly a very difficult problem. The Brookings Institute had a conference around this point, did they not, or they are going to?

MR. ROBERTSON: I do not believe they have had one as yet on the taxation of the family units. I am not aware of it.

THE CHAIRMAN: I am about to come to the end. I have one question on the last paragraph. Is there anything before that? I am up to page 36.

COMMISSIONER BEAUVAIS: On page 36 you mention that:

"A forthright admission of this would clear the way for reshaping the estate tax so as to avoid the apparent inequities involved in its applications to survivors of the same generation, namely spouses."

Have you given thought also to widows' pensions?

MR. ROBERTSON: This is partially what I had in mind. I think we have a feeling -- and it is only a feeling -- that somehow or other the widow, or widower, should be able to carry on the standard of living, and so on, that was achieved for them. There is very little evidence that I know of that backs up these very general contentions that are made very often. In the pension field that seems to be the most difficult area of finding a solution.

THE CHAIRMAN: Yes, indeed. We, of course, are puzzled as to whether there should be a succession in the same generation as between husband and wife, or whether a succession should only occur when it goes down a generation. That is something certainly to consider.

MR. ROBERTSON: I suppose you have to arrive at an answer by deciding what the estate tax is trying to do. If it is only trying to raise revenue, then you ignore that thing. If it is to have the social purpose of equal opportunity for every generation, then the other idea fits in.

COMMISSIONER GRANT: On page 33, at the

bottom of the page, the conclusion, I take it, is that if the surtax is to be placed upon a graduated scale we might just as well remain with the present progressive system?

MR. ROBERTSON: I would think so. If there is any virtue in a switch it is because we have simple rates, single rates, or a dual rate. Once you get away from that you might as well stay roughly where you are than juggling some other way.

COMMISSIONER GRANT: I just want to know I interpret that correctly.

MR. ROBERTSON: Yes.

THE CHAIRMAN: I am turning over to the summary, and I observe you draw attention to having regard to federal-provincial relations in writing the report. Certainly I do not think we can ignore it, and I am puzzled as to the extent to which one must have regard to that. Our terms of reference very clearly tell us to take into consideration all levels of taxation. We are only reporting to the federal government. In reporting to the federal government, I suppose one can always recommend to them that they endeavour to reach accommodation with the provinces in certain areas; or if the provinces will do such and such, they can do something else. I do not know how one can go very much beyond that. What are your thoughts?

MR. ROBERTSON: I would have been inclined to agree. You just have to note you have taken these things into consideration, and you can perhaps expound

a bit on how much might be done, what accommodation might be reached. I am sure the governments involved would like to have your thoughts on the matter, but beyond that, as long as it is indicated you have taken these things into account, I do not know how much further you can go.

THE CHAIRMAN: I think most of us are inclined to the view that economic controls can best be administered at the federal level; and if that be so, it may be that taxes should be reshaped to give effect to that a little better. In order to accomplish this one might say it would be better if such and such taxes were in the federal hands. But one cannot very well come down and recommend it, I do not think, within our terms of reference, could one?

MR. ROBERTSON: I really do not know. It is a matter of how the words come out at the end.

THE CHAIRMAN: You have written this submission so nicely I thought I would try to get you to write our report for us!

COMMISSIONER PERRY: I do not even think we dare recommend the implementation of the Russell report.

THE CHAIRMAN: I have come to Appendix B, which I would like to comment on a little bit, because I found Appendix B extraordinarily good reading. To me it was very helpful to have an examination of the reasons for progressivity and the reasons against progressivity. I think I

-7

understand it a little bit, and certainly I propose to read it again and perhaps more than once. We shall find ourselves discussing our personal taxation many times, and in doing so I want to be sure we have had full regard to what is said here. But you talk about the possibility of making taxation less progressive. As I read that it occurred to me that this can really only be achieved and help to produce the same revenue if we increased taxation at the lower rates, is that not correct? If we leave persons with, say, $4,000 of taxable income down unchanged in the amount of their tax and reduce the progressivity.

MR. ROBERTSON: Yes, that follows. I think it is stated as such in the comments here. There is no doubt about it.

THE CHAIRMAN: If one reduced progressivity, I think the upper levels of taxation have relief, and that has to be made up somewhere. It must be imposed on the middle or the lower graphics.

MR. ROBERTSON: There is the one other way of looking at progression, and that is in the tax system as a whole. It is not inconceivable in reducing this, say, in the income tax level it might make the income tax a more useful vehicle for shifting, say, the real property tax up for educational purposes, just as an example.

THE CHAIRMAN: Just as an example.

MR. ROBERTSON: That seems to be a fairly good one, because most people think it is

rather regressive. If this was shifted up you might conceivably end up with more progression in the tax system as a whole.

I think I understand it now that the income tax progression on the one hand is outweighed by the regressive features of real property tax on the other. There would be a shift upwards if, for example, the payments that are now made for, say, old age security were shifted all the way up, or even the unemployment insurance tax. All these things would go towards progressivity, and there would be some new counter-balance achieved there.

COMMISSIONER BEAUVAIS: Is that not what is happening in the U.S. right now? They are replacing the progressivity without increasing any bracket?

THE CHAIRMAN: But they are cutting their revenues, and I took this on the basis of not cutting revenues. It is very difficult to do this in the personal income tax structure without making a shift from one group of taxpayers to another group, and putting something up.

MR. ROBERTSON: Yes, the only way this can be redeemed is by going to these other payments and shifting those; but as a general proposition it is absolutely correct.

THE CHAIRMAN: I did not spend a lot of time searching for an increase in progressivity on income tax without increasing other rates, because you cannot do it.

MR. ROBERTSON: It is almost by definition.

THE CHAIRMAN: If you take them off the top you have to add them somewhere down below the top.

MR. ROBERTSON: It is just that per individual this switch may not appear as great because that switch is spread so far. But nevertheless it is absolutely true that what you take from one goes on to somebody else.

COMMISSIONER GRANT: There have been those before us who have said that the fact the lower income earners in the country are not subject to tax or based upon our present exemptions, means that they are not contributing as they should to the government of the country; and that this might be accomplished, not by reducing the exemptions or collecting income tax from them, but by collecting sales tax from them at the retail level.

MR. ROBERTSON: I think we are collecting it from most people now, either through manufacturers' sales tax or retail sales tax.

COMMISSIONER GRANT: Of course, but in the case of making it up by broadening the base.

MR. ROBERTSON: This really gets down to one's philosophy, where the tax should come from, and this is the benefit idea. It is, again, a matter of personal judgment. I suppose you could even say it is a matter of political judgment, in that case.

COMMISSIONER GRANT: Of course, the opponents to that point out they are contributing not only in federal taxation but in a very substantial way to the municipal taxation.

MR. ROBERTSON: Yes, that is quite true.

THE CHAIRMAN: I wonder if it is fair to suggest that our progression is compounded more of tuition, of political expediency, than of reason or justice? Surely, political expediency must be in some way related to justices? What is political expediency? It is the wish of the majority of the people, I suppose. Is it not in order that the politicians may get elected? Is not that what we think of? In order to get elected it is their best guess as to what most people want. Is not justice in some way mixed up with what most people want in a tax system? As to how the taxes are fairly spread must have regard, to some extent, I would have thought, to the wishes of most people. Are you not using the rather base phrase in political expediency?

MR. ROBERTSON: Of course, justice depends on which side of the bench you are on, I suppose.

THE CHAIRMAN: On what?

MR. ROBERTSON: On which side of the bench you are on.

THE CHAIRMAN: Do you think it is subjective?

MR. ROBERTSON: I think there is a good bit of subjective reasoning to it. It may be a

rather class phrase, but when one looks at the different degrees of progressivity, if justice is something that can be drawn out and you can say "This is justice, and this is not", then I do not know why we have such a variation in slopes between countries.

THE CHAIRMAN: That may have something to do with the payments you make for family allowance and old age pensions. There is more justification for a higher degree of progressivity under those circumstances; or it may have something to do with the weight you place on indirect taxation.

MR. ROBERTSON: There are a number of factors.

THE CHAIRMAN: I have an idea it may just be possible that what you call political expediency may be a very valuable factor in the matter of shaping a tax plan fairly.

MR. ROBERTSON: It is probably the most significant factor.

THE CHAIRMAN: I do not think perhaps though that if we could settle all our tax problems by popular poll that would solve the problem. I think I will stop short of that.

COMMISSIONER WALLS: Is it not a matter of the Commission interpreting what the legislature thinks the people want?

THE CHAIRMAN: I think so. I would not think our job was done satisfactorily if our job is merely trying to make up our own mind as to what

the people want. I think you have to be more objective, perhaps philosophical.

MRS. McGREGOR: May I enlarge upon that, Mr. Chairman.

THE CHAIRMAN: I wish you would.

MRS. McGREGOR: In Appendix B you notice I quote Blum and Kalven, for the simple reason they are people who seem to have made the most exhaustive study of this question by itself. This introduction to the paper back edition of "The Uneasy Case" rock me and them. I have been in correspondence with Professor Blum, whom I once met. He replied they are completely rocked by the discovery people are completely indifferent to income tax in itself, in the first place, except it is a nuisance to pay it; but as for principle and reasons it is imposed, and the amount imposed, they are completely indifferent. And in the scale of the subjects that interest them the income tax questions of progressive, graduate, proportional, are completely down the bottom of the line. They have said everybody can understand the idea that the rich man pays more than the poor, but that he pays more than the proportionate amount of the poor is beyond their comprehension. I asked Professor Blum if this was because they had taken a particular kind of people to ask, or whether they had gone into the survey very hurriedly, or whether it covered a very small segment of the population. He said this was the shocking part of it. They had interviewed a cross section of people who had

consisted of professional people as well as wage earners -- doctors, lawyers, accountants, teachers and a whole list. He said some of the interviews had gone for as long as two and two and a half hours with individuals. They have no explanation, and they merely feel they are more puzzled now than when they started. So what the people want seems to be something one can almost ignore in the context.

MR. ROBERTSON: Except when a change is made.

COMMISSIONER PERRY: It seems to be true that generally people are quite ignorant of financial matters. There have been similar surveys made of the knowledge of even the very intelligent people regarding the cost of instalment financing, and they have shown that people while they may not be hopelessly ignorant, they are not very much interested in whether they are paying 10 or 24 per cent, and quite often they are paying 24 per cent without realizing it. This is probably just part of the general attitude towards financial matters. Really, people are not very well versed in them.

COMMISSIONER GRANT: I should think deduction at the source contributes considerably to that lack of interest.

MRS. McGREGOR: Yes, that is why we have it, so people do not realize what they are paying. Otherwise we would have a revolution.

THE CHAIRMAN: I think if these gentlemen conducted their survey immediately after we had had a substantial change in the rate of tax upwards they

might find there is not only more interest but more understanding.

MRS.McGREGOR: They probably would find more resentment. There are a lot of people just mad with governments anyway, and particularly mad with taxes, and any politician who stood up and said, "If I return to power I will reduce taxes" would be popular immediately.

COMMISSIONER GRANT: I could give you an instance where that did not work, but I would be particularizing then.

COMMISSIONER PERRY: There is the remote possibility these results are a reflection on the skill of lawyers in carrying on public opinion surveys.

MR. ROBERTSON: That is not to be discounted. If I am not mistaken they did have help at the university.

MRS. McGREGOR: They were adopting the methods used by others to see if it would work. It was largely an experiment, but the results just left them speechless, I think.

THE CHAIRMAN: I am here to testify we have not conducted these hearings in a complete void of ignorance or apathy, but those appearing before us are in the professions, a very wide range of professions.

MRS. McGREGOR: They did qualify the statement by the almost complete absence of public interest. They said, "Except among the elite", and one assumes you have been seeing the elite here, Mr. Chairman.

COMMISSIONER MILNE: There are two areas slightly related. The one in the earlier part of the brief where reference is made to the studies undertaken by the Commission, and the Foundation urges that as many results from this research work as possible should be published. I was not just certain how you would develop that. The other is in the summary, where you suggest that in the Commission's report there would be reflected the range of alternatives that have been presented in wide scope. I realize those arenot related entirely, but there is some relationship.

MR. ROBERTSON: What was in mind there, I think, was much along the lines we are discussing now, that anything that assists the general taxpayer to understand why he is taxed in a certain way is beneficial to the community.

COMMISSIONER MILNE: I felt this was pertinent in view of the words that have just come forward. Because if we accept that taxpayers as a group are not interested and do not care, then the report in reflecting the alternates, is not going to do too much except possibly for the sophisticated people. Thus, on the other hand, I do not think we can discount entirely there will not be a general apprehension among taxpayers as a whole because of the great interest that has been generated through the country because of the Commission's hearings.

MR. ROBERTSON: It may be this apathy that Professors Blum and Kalven speak of is because a lot of

the information and basic series just was not readily available. I think a good part of this Commission's benefit has been in the process of education for all of us, and the public and taxpayers in particular.

THE CHAIRMAN: I have here a quotation from Eisenstein in his "Ideologies of Taxation":

> "Our statesmen commonly suggest that tax policy represents the collective choice of the American people as expressed from time to time."

They had a pious and ponderous thought I tried to put over a minute ago.

> "And intelligent choice, however, presupposes an adequate understanding. Most voters are not even dimly aware of the nature of our income tax."

So he seems to join that school.

COMMISSIONER PERRY: An interesting dilemma here is I think most of these sociologists say the public tends to accept better things they understand. We have had at least 100 people arguing before us that the public should understand taxation so it will reject it better. I must say there is always the question to be settled here.

COMMISSIONER WALLS: Perhaps to educate the public, therefore, as a textbook in schools, a compulsory textbook, we could put "Taxation in Canada".

MRS. McGREGOR: Is the office still receiving

royalties?

MR. ROBERTSON: You are going to make homework more difficult for the parents.

THE CHAIRMAN: Have you any further questions?

COMMISSIONER BEAUVAIS: When I talked about what is happening in the U.S., of course, it will mean that the revenue would be cut, but is it not a fact, or can we not presume it is to give a boost to the American economy? If it is achieved, it means that profits in general will be increased. Therefore, taxes will come back as a counterpart of that reduction in the income of the government, as a result of the decrease in rates.

MR. ROBERTSON: I think that is one of the basic series that proposals in the U.S. are based on.

THE CHAIRMAN: What is the latest news as to how much is coming back?

MR. ROBERTSON: I think the Senate has approved the bill that the House passed some months ago. I am not certain of that.

THE CHAIRMAN: No, what is the latest news as to how much of the $11 billion is going to be recovered by increased activity?

MR. ROBERTSON: There seems to be a little bit of debate on that.

THE CHAIRMAN: I remember seeing a figure developed by the University of Wisconsin, which I sent around to the Commissioners at the time, but that is long out of date now, and I suspect somebody has

some better figures since.

E-18 MR. ROBERTSON: In that area you begin to wonder if a t20 per cent cut is going to do that, would not a 40 per cent cut be twice as good -- and so on.

THE CHAIRMAN: We have no further questions, Mr. Russell, Mr. Robertson and Mrs. McGregor. It just remains for me to say how glad I am we did arrange for you to be the last ones to appear before us and do this sort of round-up which, I think, has left us in the right position now to proceed to write our report.

It seems to me you have given us a chance to wear some of the thoughts that have rubbed off on us, and particularly to try out one or two ideas of which we may have had some personal suspicions. At the time of our discussion today nothing of what I said has been collected, because we have not really come together yet to try to shake down any ideas; but certainly when I was testing the ideas I tested they were merely thoughts in my own head, and they were not Commission thoughts at all. I was delighted at the opportunity to meet with you in a very general way to discuss the whole area, as you have provided. Certainly, in the future I shall keep this text very close to hand, and before the Commissioners.

It is very hard to thank you adequately, and I suppose if you consider all this in the course of your duties, I certainly feel the Tax Foundation has discharged an immense trust extraordinarily well;

and if we have a fairly good tax system in Canada -- and you have suggested, I think, and others have suggested we do -- it is in some measure due to the Tax Foundation who have certainly done their best to head off great inroads in the tax base. As far as I can see, Canada has quite a firm tax base. In my view this is due more than anything to the Canadian Tax Foundation. Thank you very much, gentlemen, for being here today, and for what you have done for us.

MR. RUSSELL: Mr. Chairman, it might be appropriate at this time if we were to express to you and the Commissioners, not only on behalf of the Foundation itself but also on behalf of the many Canadian taxpayers who have appeared before you, our thanks for the very courteous way in which we have been received by this Commission and yourself. Speaking as one who has appeared before you now four times I think I am probably an authority on that subject.

We also congratulate you and the Commissioners, and your staff, on the very hard and efficient work you are doing. We wish you well in your continuing efforts leading to the publication of your report. We appreciate very much this opportunity of winding up your public hearings.

THE CHAIRMAN: I am glad that you are with us on our last day.

THE SECRETARY: Mr. Chairman, there are one or two other items of business. I have here a brief which was delivered to this Court room this morning by Mr. C.W. Saddington of 35 Dundurn Road, Toronto 12. He is a chartered accountant, and a former comptroller of the Confederation Life Assurance Company. He is in attendance. I will enter this submission into the record as Exhibit No. 346.

--- EXHIBIT NO. 346: Submission of C.W. Saddington entitled "Capitalism -- Individual, Corporate or State in Canada."

THE SECRETARY: This concludes the agenda for our public hearings. Before we close, Mr. Chairman, it might be interesting to record the fact that the Commission has held public hearings on 99 days throughout Canada, and during this time we have received 214 briefs from persons, private and corporate, and many other associations and organizations, who have appeared before you. Altogether, Mr. Chairman, some 700 witnesses have come forward to speak to these submissions on behalf of themselves and their associations. In addition I have entered into the record 91 submissions on behalf of other individuals and groups who have forwarded their briefs to the Commission, and added to this there were 41 additional exhibits entered into the record, making a total of 346 exhibits in all.

Finally, Mr. Chairman, as Secretary of this Royal Commission, I would like to express appreciation and thanks to the hardworking reporting staff of Angus Stonehouse & Company Limited, who have recorded somewhat over two million words of evidence at these hearings.

I would also like to express our appreciation to our friends of the Press who have been with us throughout, and who have so ably reported the proceedings. I refer particularly to Mr. Stewart MacLeod of Canadian Press, Mr. Art. Turner of the Western Producer of Saskatoon, who unfortunately could not be here this morning, and Mr. Roger Vincent and Mr. Jack Kirk of C.C.H. They have long sincebeen

considered part of our team.

Royal Commissioners, it has been a pleasure for your staff to have served you during these hearings, and I thank you.

THE CHAIRMAN: Mr. Beauvais wishes to say a word or two in French.

MR. BEAUVAIS: La Commission a commence ses travaux en Octobre, 1962.

Elle a tenue des seances a partir du debut d'avril 1963, et vient ce matin de les terminer en entendant le memoire soumis par Canadian Tax Foundation.

Ces seances ont ete tenues dans la plupart des villes de chacune de nos dix provinces ainsi qu'au Yukon et dans les Territoires du Nord-Ouest et enfin a Ottawa pour les memoires de caracteres national.

En tout 305 memoires nous ont ete soumis par les representants de chacun des serteurs de notre economie, industrelle et econimicale de nos professions liberales telles que le Barreau Canadien, les Medicine, les Comptables Agrees, les Architectes, certaines Universities, La Chambre de Commerce Canadienne, L'Association des Manufactureurs, l'Association des Bangiers, le Congres du Travail, les Societes de Fiducee, l'association des Fermiers ainsi que par des personnes iminentes qui se sont donnes beaucoup de trouble pour nous presenter un travail de recherches qui nous sera precieux.

La plupart des memoires ont ete d'une excellente qualite et leur presentation des plus satisfaisantes.

F-4 Les principaux sujets traites ont ete sur la taxe sur le profit des Corporations et la distribution de leur surplus, la taxe sur le revenu personnel, la taxe de vente et d'accise, la taxation des dividendes, les droits successoraux, et les allocations pour les dependants.

Notre personnel va maintenant etudier ces memoires et nous presenter leur etude afin que nous puissions rediger notre rapport sur nos recommendations qui sera termine, nous croyons, til que prive vers la fin de la presente annee.

Je me joins avec grand plaisir au President de notre Commission pour remercier le representant de la Presse. Canadienne, M. Stewart MacLeod, ainsi que les representants du C.C.H., et de la maison Angus, Stonehouse pour leur excellent reportage et pour leur cooperation.

THE CHAIRMAN: I would like to make a few remarks myself in closing our hearings. I wish to express the gratitude of the Commissioners and myself to, firstly, our staff who have managed to combine the great efficiency with a high degree of wisdom. At times we have complained of insufficient work, and at times we have complained about its excessive burden. Such complaints have been received, as deserved, with great sympathy and no action. We will all agree thatsuch complaints as we voiced had no substance whatsoever. Our counsel have led our interrogations through difficult technical areas with skill and good humour.

I would like to thank the President and the learned Judges of the Exchequer Court of Canada, and to Mr. Gabriel Belleau, Q.C., the Registrar, and his staff for the hospitality and assistance that they have given us. These premises could not have been more suitable to our hearings, and we regret our departure from these hallowed halls.

I would like to thank the Board of Transport Commissioners for the use of their courtroom during the spring of last year.

Our thanks go too to those we have termed our "participants" who cheerfully prepared many hundreds of pounds of briefs and subjected themselves to a persistent interrogation. Many of their submissions have been of the highest quality.

We thank the Press. We recognize the importance of communications, and we have noted that the public has been kept well informed of the submissions made to us and that, I think, is a matter of great importance.

The representations made to us have been as varied as are the people and conditions of this vast country. They have stressed the development of outlying areas, particularly in the north, by encouraging migration and industry to those parts; stimulation of depressed areas by various devices, including tax remissions and incentives; greater consumption by the reduction of personnel and consumption taxes; greater investment by the reduction of business taxes and other measures to encourage

industrial development; more equitable taxation of women who seek to demonstrate that, in certain respects, they suffer discrimination; reduction of alleged punitive taxation at high personal rates; reduction of alleged regressiveness of taxation at the lower levels; industrial incentives of various kinds, although many have rated them below reduced taxation generally; desirability or otherwise of capital gains taxation; and the elimination of corporation tax.

We have been told of new tax bases and, in some cases, have had set before us complete new tax systems. It has been suggested that sales tax should, and should not, be levied against each of the manufacturer, the wholesaler and the retailer. IfEstate tax would be eliminated by some, and altered by others. Many have recommended means of improving communications between the business world and the ministers and officers charged with drawing and introducing tax laws. Virtually everybody has stressed the need for clarity, simplicity, certainty and brevity in our laws, and absolutely all have favoured lower taxes.

The Royal Commission procedure of public hearings has impressed us as a useful means of learning the wishes of the Canadian people. Really these wishes must be taken into consideration in recommending tax reforms. It has been made clear to us that all Canadians are affected in some measure by taxation, and it is evident that most of these

people wish to have some say in the way the laws are drawn. However, what we have heard has been so diverse that it seems obvious that whatever we recommend will find support in some quarters. It is equally clear that our recommendations could not meet the wishes of all.

We now propose to devote our energies to a report, recognizing that it is our task to recommend the distribution of the tax burden so as to obtain the greatest equity, and damage the economy as little as possible, as directed by our terms of reference. We must remember that whatever may be forthcoming taxation will continue to be a burden but, if our recommendations are good, it will be more readily supportable.

These hearings have provided a stimulating and enjoyable experience for these Commissioners, and we have been most fortunate in being afforded an unusual view of this prosperous and promising country.

With these words I conclude our hearings.
